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IN THE

SUPREME COURT OF THE UNITED STATES

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OCTOBER TERM, 1992
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DR SEYMOUR LICHT P.E.

Petitioner

vs.

TEXAS COMMERCE BANK ET AL

Respondents

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR WRIT OF CERTIORARI

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DR SEYMOUR LICHT P.E.
14002 NORTH 67TH PLACE
SCOTTSDALE, AZ. 85254
(602) 948-1730
Petitioner
Pro. se.

QUESTIONS PRESENTED

1. Where an interest bearing debenture is voluntarily exchanged for a **"Zero Coupon"** debenture plus other consideration (**"BOOT"**): must the value of the **"BOOT"** be subtracted from an exchanging debentureholder's claim in a subsequent bankruptcy proceeding?

2) Is unmatured interest on a "Zero Coupon" debenture allowable as a claim under 11 U.S.C. Section 502 (b)(2)?

3. Did the Fifth Circuit err in holding that the allowed bankruptcy claim of an unmatured $1,000.00 **"Zero Coupon"** bondholder is equal to the face amount of the **"Zero Coupon"**?

4. Can a Court of Appeals base its ruling on facts that are not contained in the record before the trial court?

PARTIES TO THIS PROCEEDING

The Petitioner respectfully certifies that the persons or corporations listed below may have an interest in the outcome of this litigation:

1. Dr Seymour Licht P.E.
2. Anthony Ben Walsh
3. Mathew S. Metcalf
4. Estelle Simsolo
5. Christi Todd
6. Edwar L. Rothberg Esq.
7. Pengo Industries Inc.
8. Texas Commerce Bank N.A.
9. Edward Booth Esq.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

TO: The Honorable, Chief Justice and Associate Justices of the Supreme Court of the United States

PRAYER

The Petitioner, **Dr Seymour Licht P.E.** ("Licht"), respectfully prays that a Writ of Certiorari be issued by the United States Supreme Court to review the Opinion of the

United States Court of Appeals for the Fifth Circuit entered in this case on June 12, 1992. (See App. A33)

OPINIONS BELOW

The United States Bankruptcy Court for the Norther District of Texas, Fort Worth Division, sustained Licht's objection to TCNB's claim for the face amount of Pengo Industries 0% debentures, on grounds that the face amount of the unmatured debentures included unaccrued interest that was disallowed under 11 U.S.C. Section 502 (a)(2). The bankruptcy court's decision is reported as In re Pengo Industries 129 B.R. 104 (N.D.Texas 1991) and is reproduced in App. C for the convenience of the court.

The United States Court of Appeals for the Fifth circuit affirmed the Decision of the United States District Court for the Northern District of Texas on June 12, 1992 and was

reported at ____ F.2d _____(5th Cir. 1992) WL 4985 and is reproduced hereto as App.A.. The District Court's opinion/order, [Texas Commerce Bank Nat'l Ass'n v. Licht (In re Pengo Indus. Inc.), 129 B.R. 104 (N.D. Texas 1991)] Pengo which reversed the Bankruptcy Court's order sustaining Licht's Objection to TCNB's claim is reproduced in App. B. and was reported at ____ Fed Sup (Fort Worth D.C.) ____.

The Fifth Circuit's Opinion appears at A-1.[1] The District Court's opinion is reproduced here at B-1. The Bankruptcy Court's order sustaining Licht's Objection to TCNB's Claim appears at C-1

STATUTES

This case involves the scope meaning and intention of Congress when it enacted the

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[1] A, B, C, stand for the Appendices attached to this Petition.

Bankruptcy Code, and specifically Section 502(b)(2)

TITLE 11 U.S.C. SEC. 502(b)

"(b) Except as provided in subsection (f), (g), and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that (emphasis added)-

(2) such claim is for unmatured interest; (Emphasis added)

THE FOLLOWING SUPREME COURT RULES ARE APPLICABLE TO THIS PETITION

RULE 10(1)(C), RULE 13.4 and is reproduced in Appendix F.

JURISDICTION

This Court has jurisdiction over this matter under Title 28 U.S.C. Section 1254(a).

The Opinion and Judgment of the Fifth Circuit affirming the District Court was filed on June 12, 1992.

On June 22, 1992 Appellant/ Licht filed a "Petition for Panel Rehearing. On July 10,

1992 the Fifth Circuit denied Licht's Petition for Rehearing (See App A33). This Petition is filed in accordance with Rule 13.4 of the Rules of the Supreme Court of the United States. This rule requires that a Petition for Writ of Certiorari must be filed within ninety (90) days after the Fifth Circuit denied Licht's Petition for Rehearing. In this case the 90 days terminates on October 8, 1992

The decision of the Fifth Circuit in the present case is in direct conflicts with the intent of the United States Congress to promote out-of-court consensual workouts. Furthermore the Fifth Circuit's decision is in direct conflict with its own decision in Gulf, Mobile and Ohio R.R. Co. v. United States, 579 F.2d 892 (1978), with the Tenth Circuit's ruling in Atchinson, Topeka and Santa Fe R. Co. v. United States 443 F.2d 147 (1971), with the Ninth Circuit ruling In re Nucorp Energy

Securities Litigation 772 F2.d 1486 (1985) and lastly in conflict with the Supreme court's ruling in Commissioner of Internal Revenue v. National Alfalfa Dehydrating and Milling Co. 417 U.S. 134 (1974).

REASON WHY THE SUPREME COURT SHOULD REVIEW THE ORDER OF THE FIFTH CIRCUIT

In Reading Co. v. Brown Pa. 1968 88 St.Ct. 1759, 391 U.S. 471, 20 L.Ed.2d 751. the Supreme Court stated:

> **"United States Supreme court granted certiorari where issue was important to administration of bankruptcy law and was one of first impression in Supreme Court."** (Emphasis added)

This is a case of first impressions before this court.

The Fifth Circuit held below that certain unsecured creditors who received/ possessed allowed claims equal to the face amount of their **"Zero Coupon"** bonds.This bond was obtained along with other significant consideration ("Boot") in an out of bankruptcy

voluntary exchange offer for an existing interest bearing security.

Unquestionably the **"Zero Coupon"** bonds bore interest, both for bankruptcy purposes and taxation purposes. The interest was submersed in an Original Issue Discount ("OID"). Section 502(b)(2) of the Bankruptcy Code mandates the disallowance of unmatured interest claims.

The prolonged economic recession has caused a significant increase in the number of business failures resulting in a large increase in the number of out-of-bankruptcy restructurings. The recession has also caused an increase in bankruptcy filings after the restructuring failed to rejuvenate the debtor.

It is in the best interest of the nation's economy that the Supreme Court provide clear direction both to the circuit courts and to the business community regarding

means of restructuring debt outside of a bankruptcy proceeding. The Fifth Circuit's affirmation of the District Court's reversal of the Bankruptcy Courts order and the Second Circuit's opinion in Chateaugay 961 F.2d 378 (1992), 1992 WL 71134 will "Chill" future attempts of troubled corporations to restructure their debt out of bankruptcy. No Senior creditors can be expected to participate in a voluntary restructuring such as in the present case where the Fifth Circuit has held that their claims will be diluted through capitalization of interest that otherwise is disallowed in a bankruptcy proceeding.

This action would clearly be contrary to the intent of Congress when it enacted the bankruptcy legislation and also not in the national interest.

CONFLICT OF THE FIFTH CIRCUIT'S RULING WITH PREVIOUS SUPREME COURT'S DECISION

The Fifth Circuit's ruling in the case at bar conflicts with this Court's ruling in Commissioner of Internal Revenue v. National Alfalfa Dehydrating & Milling Co. 417 U.S. 134 (1974) where the Court held that there is no OID generated when there was no new capital acquired and no additional cost incurred in retaining the old capital:

> "The capital "freed" by cancellation of the preferred was merely transferred to the liability account for the debentures. No new capital was involved. see *Claussen's, Inc. v. United States*, 469 F.2d 340(CA5 1972)"

In the instant case each 8.5% bond that was exchanged for a 0% bond resulted in the removal from Pengo's balance sheet the liability for interest accrued on the original bond but not paid from Dec. 1, 1983 forward. Moreover Pengo reduced on its balance sheet its liability for each bond exchanged from $1,000.00 to $320.00, the market value of the 8.5% bonds at the time of the exchange.

This Court concluded in National Alfalfa at 153:

> "The fixed interest on the debentures was equal to the cumulative dividend on the preferred, and both the preferred and the debentures worked equal diminutions in the earnings otherwise available for common shareholders."

There is no OID if the exchange results in no significant change in stockholder equity of the corporation involved. Pengo's exchange, however resulted in a significant change to Pengo's capital structures: stockholder equity increased approximately $913.74 ($233.74 elimination of the accrued unpaid interest and $680.00 in reduction in long term debt) for each 8.5% bond exchanged. Pengo's "First Exchange Offer" did generate an OID.

CONFLICT OF THE FIFTH CIRCUIT'S RULING WITH ITS OWN AND OTHER CIRCUITS RULINGS

Addressing a bond for bond exchange, the Tenth Circuit held in Atchison, Topeka and Santa Fe R. Co. v. United States, 443F.2d 147,

153 (1971):

> "We believe that the discount is still to be treated as interest...(citing American Smelting & Refining Co. v. U.S. , 130 F.2d 883, 885 (3rd Cir. 1942)... bond interest is reflected both by the stated rate of interest and the amount below or above par received by the issuer..."

at 147 the Tenth Circuit stated:

> "Income tax refund suit involving question whether reorganized railroad company incurred amortized original issue discount in issuing general mortgage and adjustment bonds to persons who had held general mortgage bonds before reorganization. The United States District Court for the District of Kansas, Arthur J. Stanley, Jr. J., entered judgment for taxpayer and government appealed. The Court of Appeals, Adams Circuit Judge, held that evidence supported determination that the new bonds were issued at a discount." (emphasis added)

The Fifth Circuit's own ruling in Gulf, Mobile & Ohio Co.v. United States 579 F.2d 892 (1978) also conflicts with the ruling in the instant case. The Fifth Circuit held in Gulf, Mobile that in an exchange of debentures for preferred stock there was an OID that equalled

the difference between the value of the shares and the face amount of the debentures.

The Fifth Circuit's Pengo's order conflicts with the Ninth Circuit holding in re Nucorp Energy Securities Litigation that:

> "subsequent purchasers of convertible debentures **did not acquire** New York cause of action against indenture trustee for breach of fiduciary duty, willful misconduct, fraud, deceit and negligence when they acquired the debentures from the original purchasers." (emphasis added)

In Pengo the Fifth Circuit stated at WL 4993:

> "The bankruptcy system revolves around the policy that all creditors who are similarly situated are entitled to fair and equitable treatment....."

Based upon the above Fifth Circuit's herein a holder of a **"Zero Coupon"** Bond who obtained his bond by exchanging his 8.5% bond for which he paid $1,000.00 would have the same claim as a person who purchased a "Zero Coupon" bond in the secondary market for $50.00 after the bankruptcy petition was filed.

This result contradicts the Fifth Circuit's stated rationale of decision in Pengo:

> "A rule that a debt-for-debt face value exchange in a consensual out-of-court workout creates OID commitantly reduces the likelihood that creditors will "cooperate with a struggling debtor" because such a rule lowers the exchanging creditors' claims in bankruptcy. Creditors faced with the choice of either refusing to exchange or accepting the exchange offer would certainly realize that if they choose to exchange, their claim in a subsequent bankruptcy proceeding would shrink by the amount of unamortized OID."
>
> "Such a rule would grant [] a ... windfall... to holdouts who refuse to cooperate."

STATEMENT OF THE CASE[2]

In 1984 Pengo restructured its debt. As part of an out of bankruptcy restructuring

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[2] All facts stipulated to in the Bankruptcy Court are undisputed and are supported by the Bankruptcy Court docket. The Fifth Circuit in its Sept. 11, 1991 order (see copy App. A 32) amended the record to include excerpts from Pengo's "First Bond Exchange Offer" and said order is reproduced in App.E.

Pengo offered to exchange its 8.5% Convertible Subordinated Guaranteed Debentures due 1995 for $1,000.00 **"Zero Coupon"** Senior Subordinated Debentures due 1991. Each $1,000.00 principal amount of 8.5% Convertible Subordinated Debenture would be exchanged for $500.00 Class A and $500.00 Class B "Zero Coupon" Convertible Senior Subordinated Debenture due 1991 ("Zero Coupon Bond").

Pengo subsequently became subject to an involuntary bankruptcy in 1988.

The indenture trustee for the **"Zero Coupon"** bond Texas Commerce Bank N.A., ("TCNB") then filed a claim on behalf of all of the **"Zero Coupon Bond"** bonds equal to the face value of the bonds of $1,000.00 per bond.

Dr Seymour Licht P.E., the petitioner, ("Licht") objected to the claim filed by TCNB stating that TCNB's claim on behalf of the owners of the Zero Coupon Bonds contained

"Unmatured Interest". The Official Unsecured Creditor's Committee joined with Licht in the objection.

On May 18, 1990 the Bankruptcy Court sustained Licht's objection (see App.C ruling in part) and stated:

> "WHEREFORE, IT IS ORDERED that the objections to the TCBNA claims, as amended, hereby are sustained, and the Class A Debentures in the amount of $2,076,500.00 and on behalf of the holders of Class B Debentures in the amount of $2,236,000.00, hereby are reduced to $1,411,812.35 and $1522,626.40, respectfully, **to eliminate unmatured interest**;..." (emphasis added)

TCNB appealed and the District Court reversed the bankruptcy court. (see Appendix B):

> Based on the facts that the claim submitted by TCBNA did not include any claim for original issue discount. The bankruptcy court erred as a matter of law in concluding otherwise. Accordingly,
>
> The court ORDERS that the bankruptcy court's order ,sustaining objections to TCBNA's claim be and is hereby reversed."(Emphasis Added)

The District Court further stated:

> "The offering circular in this case was not admitted into evidence at the trial and is therefore not considered as evidence on appeal.... The statement contained in such offering circular would not be dispositive in any event.'

Licht takes exception to the above statement made by the District Court. The Bankruptcy court never conducted a trial. Oral arguments were presented and then the court ruled from the bench.

Secondly what an accepting Pengo bondholder knew or should have known at the time of the exchange is contained in the "Offering Circular". Consequently by its very nature the information contained in the "offering Circular" is dispositive if it relates to the question presented to the District Court!

On July 19th, 1991 Licht filed a "Notice of Appeal" with the clerk of the District Court. The Official Unsecured Creditor's

Committee of Pengo joined in with Licht in pursuing said appeal.

On August 10, 1992 Licht filed a "Motion to Include in the Record of Appeal Excerpts from Pengo Industries' Exchange Offering Circular" with the Fifth Circuit.

The Fifth circuit **"GRANTED"** Licht's motion to amend the "Record on Appeal", to include the front page and page 26 of Pengo's "Exchange Offering Circular" on September 11, 1991. (see App A-32)

On June 12, 1992 the Fifth Circuit affirmed the District Court's reversal of the Bankruptcy Court's order sustaining Licht's objection to the claims of TCNB as indenture trustee for Pengo's Zero Coupon bonds. In said opinion/ order the Fifth Circuit stated:

> Just because an exchange offer may constitute a realization event justifying the taxation of the participants, it does not follow that the transaction demands a corresponding transformation in the relationship of similarly situated

> creditors. *Chateaugay* ____F.2.d at _____ 1992 WL 71134, at *5; *Deleveraging Tool, supra* at 656. As bluntly stated by the Second Circuit, the reasoning underlying the tax treatment of debt-for-debt exchanges "simply does not apply in bankruptcy context"[3], Especially when polestar bankruptcy policy militates against doing so, we do not feel compelled to interpret the bankruptcy Code so as to parallel the tax rules for a transaction."

The Fifth Circuit ignored Licht's argument that Pengo's first out-of-court exchange offer to exchange a $1,000.00 Subordinated 8.5% debenture due 1995 for a $500.00 Class A and $500.00 Class B "Zero Coupon" Senior Subordinated Debenture due 1991 was only a part of the transaction. Without

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[3] The parties quarrel over whether this court should consider certain statements contained in the offering circular about the reporting of interest income by holders of the new Debentures. We need not reach the issue of whether these statements are properly before this Court. Even if we resolve that issue affirmatively, we repeat that the tax treatment of a transaction does not determine its treatment in bankruptcy.

the "**BOOT**" given to accepting 8.5% bondholders not a single 8.5% bondholder would have accepted the exchange offer. The Fifth Circuit refused to consider the value of the "**BOOT**" received by the accepting bondholder in determining the claim that they would have in any subsequent bankruptcy proceeding. Lastly the Fifth Circuit ignored the fact that the interest rate on the new bonds was significantly below current market rates, 0% in Pengo's case.

Nowhere did the Fifth circuit addressed the arguments that the value of the "BOOT" had to be considered as part of any subsequent claim. The Court narrowed the issue to one question of Original Issue Discount ("OID") as defined in the traditional sense . This left the following questions unanswered:

a) How does a bankruptcy court evaluate the effect of "**BOOT**" received as

part of the a debt-for-debt, face-for-face, exchange on a subsequent claim in a bankruptcy proceeding?

b) How does a bankruptcy court evaluate the effect of **unmatured interest** on the claim filed by a **"Zero Coupon"** bondholder which was issued in an out of bankruptcy proceeding Exchange offer?

On June 22, 1992 Licht filed a "Petition for rehearing" with the Fifth Circuit. On July 10, 1992 the Fifth Circuit denied Licht's petition for rehearing.

APPLICATION OF THE FIFTH CIRCUIT'S HOLDING APPLIED TO A TYPICAL OUT-OF-COURT DEBT RESTRUCTURING

Assume that Pengo offered to exchange its 8.5% bonds ("Old Bonds") for either a **"Zero Coupon"** bond or a **"New Bond"** that paid the exact same interest (8.5%) but its principal was reduced to a value such that the value of all of the interest paid plus the principal at

maturity [future value] would be $1,000.00.

Licht has determined that a $530.00 8.5% bond issued in July of 1984, the date of Pengo's First Exchange offer, and maturing December 1991 (7.5 years later) would have a future value of $1,000.37 on the maturity date of the Pengo's Zero Coupon bond.

The **"New Bond"** would rank equal in seniority and have the same maturity date as the "Zero Coupon" bond and would be convertible into exactly the same number of shares of Pengo common stock. For all practical purposes the **"Zero Coupon"** bond and the **"New Bond"** were exactly equal.

Lastly after making this exchange Pengo failed to pay any of the interest payments on the "New Bond" when due. Prior to both bonds maturity Pengo became subject to a bankruptcy proceeding; The questions that are being brought to this court at this time and begs an

answer are:

1) What would be the claim of a "**New Bond**" holder? Would it be the principal plus accrued and unpaid interest or would it be $1,000.00 as the Fifth Circuit and District Court has ruled?

2) Are the claims of both bond holders, the "**Zero Coupon**" and the "**New Bond**" equal because they were obtained by exchange of an "Old Interest Bearing Bond"?

The Fifth Circuit and the District Court both have stated that the claims of both the "Zero Coupon" and the "New Bond" holders are equal to $1,000.00 the face amount of the "**Original Bond**"that was exchanged.

The appellant, Licht, position is that the claim of the "**New Bond**" holder would be equal to its reduced face amount ($530.00) plus the accrued and unpaid interest up to the

date of the bankruptcy petition. The claim of the "**Zero Coupon**" bond holder is equal to the value of the "**Zero Coupon**" bond at the time of the exchange, to be determined by the court, plus the accrued amount of interest earned from date of exchange to date of the bankruptcy filing.

The "Exchange Offer" circular clearly stated in several places that upon maturity (December 1, 1991) of the "Zero Coupon" bond that Pengo would pay $1,000.00 to the holder and that part of the $1,000.00 would be considered interest (see Fifth Circuit's order amending the record on appeal, Appendix A).

STATEMENT OF RELATED CASES

Other related litigation arising from the Bankruptcy Court's are:

1) LTV Corp. v. Valley Fidelity Bank & Trust Co. (In re Chateaugay), 109

B.R. 51(Bankr S.D.N.Y. 1990), aff'd, 130 B.R. 403 (S.D.N.Y. 1991), aff'd in part and rev'd in part, No. 91-5098 961 F.2d at 378 (1992), WL 71134 (2nd Cir. Apr. 13, 1992);

2) In re Allegheny Int'l. Inc., 100 B.R. 247 (Bankr. W.D.Pa. 1989)

3) Commissioner of Internal Revenue v. National Alfalfa Dehydrating and Milling Co. 417 U.S. 134

4) Gulf, Mobile and Ohio R.R. Co. v. United States 579 F.2d 892 (1978)

STATEMENT OF FACTS

The Bankruptcy Court sustained Licht's objections to the claim of TCNB upon "Stipulated Facts" and ordered that the claim be reduced by the amount of unmatured interest calculated on a straight line bases (see copy of "Stipulated Facts" in App.D and also contained in District Court's order in App.B).

The Bankruptcy Court ruled upon the pleading and did not conduct a trial or take evidence. The District Court reversed the Bankruptcy court's ruling based upon the trial court's record, The record was devoid of any portion of Pengo's first Exchange offer Offering Circular.

The Fifth Circuit granted Licht's motion to amend the "Record on Appeal" to include page 26 of Pengo's "Exchange Offering Circular" which contained the following dispositive statement.

> "Although the New Debentures are non-interest bearing, **a portion of any amount received at maturity will be deemed to be interest income.** Holders of New Debentures who are United States Persons must report the interest deemed to be received at maturity as interest." (emphasis added)

ARGUMENT

REASON WHY THE FIFTH CIRCUIT RULING SHOULD BE REVERSED

A) OID MUST BE DISALLOWED AS UNMATURED INTEREST

Title 11 U.S. Bankruptcy Code

Section 502 (b)(2) states:

> (b) Except as provided in subsection (f),(g),(h) and (i) of this section if such objection to a claim is made, the court, after notice and a hearing shall determine the amount of such claim as of the date of the filing of petition, and shall allow such claim in each amount, except to the extent that-
>
> (2) **such claim is for unmatured interest**; (emphases added)

The Fifth Circuit stated at WL 4922:

> a) As heretofore discussed, we decide only the narrow issue of whether a debt for debt face value exchange generates OID not allowed under section 502(b)(2)....
>
> b) Next we express no opinion as to whether a fair market value exchange creates OID not allowed under sect 502(b)(2).....
>
> c) We also refuse to investigate debt-for-debt exchange and merely consider the debt-for-debt exchange represented by the facts of this case.....
>
> d) Finally this is not a tax case. We stress that the tax treatment of original issue discounting does not control our inquiry which is placed firmly within the bankruptcy frame....

Since Section 502(b)(2) clearly states that the claim for "Unmatured Interest" must be disallowed in a bankruptcy proceeding. The question that now must be answered by this court is: How is a bankruptcy claim for unmatured interest generated. See In re Holm 931 F.2d 620 (9th Cir 1991)

A claim for "**Unmatured Interest**" arising from an exchange can be generated by two separate and independent scenarios:

Judge Lifland In re Chateaugay Corp. 109 B.R. 51 (S.D.N.Y. 1990) has clearly defined "**Unmatured Interest**" resulting from an OID as:

> "The issuance of debentures with face values in excess of the consideration received by the issuer has become common place in today's financial system. The difference between the proceeds received by the issuer, before issuance expense and the face amount of the debentures repayable by the issuer at maturity is usually referred to as "**original issue discount**" (OID).
>
> In actuality, OID is nothing more or less than additional interest associated with a particular debenture when

> purchasing debentures. When purchasing debentures the "market" sets the appropriate rate of interest to compensate the purchaser for allowing the issuer to use the proceeds of the issue for a specific period of time, and for various rates associated with lending process such as inflation and the risk of nonpayment. If the proceeds from a particular issue are less than the face amount of the debentures, the "market' is telling the issuer that the stated rate of interest is too low, and the differential between consideration paid for the debenture and the amount received by the purchaser at maturity is intended to compensate the purchaser for buying a debenture with a stated interest rate below market levels. The Internal revenue Service (IRS) and the Financial Accounting standards Board (FASB) both have detailed guidelines to force the issuer and purchaser to reflect the underlying economic substance of original issue discount.

See also In re Public Service Co. of New Hampshire 114 B.R. 800 (Bkcy D.N.H. 1990).

The Supreme Court adopted this definition in National Alfalfa at 150:

> "... it is an adjustment of the difference between the interest prescribed in the instrument issued and the prevailing market rate for money, and it arises because the prescribed rate is too low to sell the obligation at par in

that market. See *Sam Joaquin Light & Power Corp. v. McLaughlin*, 65 F.2d 677, 679 (CA9 1933)."

B) WHEN A ZERO COUPON BOND IS ISSUED

The second method that would generate a claim for "Unmatured Interest" in a bankruptcy proceeding is when a debtor makes a face-for-face debt-for-debt voluntary exchange offer outside of bankruptcy and **the interest rate on the new debt is significantly less than the interest rate on the original debentures and is also significantly below market rates.**

In the instant case Pengo offered to exchange an existing $1,000.00 8.5% debenture with approximately five (5) years of accrued and unpaid interest ($425.00) for a $1,000.00 face amount of a "Zero Coupon" bond (see fact #12 App.D). The issuance of a "Zero Coupon" bond by Pengo is an extreme example where a claim would contain "Unmatured Interest" is generated if Pengo should file for bankruptcy

protection before the "Zero Coupon" bonds matures.

The Court In re Public Service of New Hampshire, 114 B.R. 803, (Bankr. D.N.H. 1989) applied the **"plain meaning rule"** to Section 502(b)(2) of the Bankruptcy Code regarding the meaning of the word interest:

> "The word "interest" in the statute is clearly sufficient to encompass the OID variation in the method of providing for and collecting what in economic fact is interest to be paid to compensate for the delay and risk involved in the ultimate repayment of monies loaned. Confirmation of this reading of the statute if needed is readily provided in the legislative history. That history makes it clear that unamortized original issue discount was classified as unmatured interest under Section 502(b)(2):
>
> Paragraph (2) requires disallowance to the extent that the claim is for unmatured interest as of the date of the petition. **Whether interest is matured or unmatured on the date of the bankruptcy is to be determined without reference to any ipso facto or bankruptcy clause in**

the agreement creating the claim."[4] (Emphasis Added)

The issuer of a "**Zero Coupon Bonds**" makes no periodic interest payments after it sells a debt security at a deep discount from its face value. The buyer of such a bond receives the rate of return, interest, by gradual APPRECIATION of the debt security, which is redeemed at FACE VALUE on a specified date. For tax purposes, the Internal Revenue Service maintains that the holder of a "**Zero Coupon**" bond owes income tax on the interest that has accrued each year, even though the bondholder does not actually receive the cash until maturity.(see Fidelity Investments "Dictionary of Financial and Investment Terms").

WHAT IS THE UNMATURED INTEREST ASSOCIATED WITH

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[4] H.R. No. 595, 95th Cong. 1st Sess. 352, reprinted in 1978 U.S. Code, Cong. & Admin. News 6308; reprinted in 1978 U.S. Code Cong. & Admin. News 5848.

A ZERO COUPON BOND?

The imputed interest of a "Zero Coupon" bond is determined by subtracting the market/ issue price of the "**Zero Coupon**", bond which in this case was $340.00, (see stipulated fact #23), from its face value at maturity, $1,000.00, and then dividing this number by the number of years between the issue date and the maturity date to obtain the interest earned per year, (7.5 YEARS). The formula results in the following:

($1,000.00-$340.00)/7.5 = $88.00/yr

It is to be noted that this annual return is almost exactly equal to the interest rate on Pengo's "Old Bonds" [8.5% = $85.00/ year]. This is not an accident for the economics of the restructuring required that this be so.

Conversely the "Unmatured Interest" of the Zero Coupon bond is then equal to the interest per year ($88.00) multiplied by the

number of years between the bankruptcy petition date, April 1988, and the maturity date Dec. 1991 (3.75):

($88.00)(3.75) = $330.00

It was this $330.00 of unmatured interest that Licht objected to as being part of the claim of Pengo's Zero Coupon bonds claim. The Fifth Circuit in its opinion/ order of June 12, 1992 did not consider when it ruled that no OID was created when Pengo implemented its "Face-for-Face exchange prior to a bankruptcy proceeding.

HOW DOES A CORPORATION RESTRUCTURE EXISTING DEBT OUT OF BANKRUPTCY?

Out-of-bankruptcy restructuring can take any one or combination of the following forms:

a) Debt for stock (preferred/ common)

c) Debt for debt (face-for-face at reduced interest and or extended maturity)

d) Debt for debt (reduction of principal) (example $605.00 bond for a $1,000.00 bond)

c) debt for cash (at a discount)

(example #400.00 cash for a $1,000.00 bond to mature at a later date)

Pengo's first exchange offer involved a combination of the above (see stipulated facts 9,12,14 and 15):

a) It was a face-for face($1,000.00 8.5 % exchanged for $1,000.00 0%
b) the interest rate was reduced from 8.5% to 0%
c) The 0% bond had a significantly improved (reduced) convertible terms.
d) The 0% bond had a shorter maturity period than the 8.5% bond
e) The 0% bond was senior to the 8.5% bond

PENGO'S FIRST EXCHANGE OFFER WAS NOT A TRUE "FACE-FOR-FACE BOND EXCHANGE?

In comparing any two convertible bonds the four (4) variables that must be considered in determining the value of the bond with all other things being equal are:

a) Interest rate;
b) Maturity date;
c) Convertability terms.
d) Seniority ranking

It is incorrect to say that when principal amount of the two bonds are the same the

exchange is face-for-face regardless of changes to other terms.

Before the Fifth Circuit can state that Pengo's "First Exchange offer' was a "Face-for-Face exchange it must determine if Pengo received any additional compensation as a result of the exchange. See Commissioner of Internal Revenue v. National Alfalfa Dehydrating and Milling Co. 417 U.S. 134 (1974).

Since the Fifth Circuit did not look at the entire exchange offer its assumption that this was a **"Face-For-Face"** exchange was inconsistent with the facts and conditions/ terms of Pengo's **"First Exchange Offer"**.

Pengo's adjusting accounting entries on its books after restructuring of its debt revealed Pengo did not consider the exchange to be a face-for-face exchange.

Prior to Pengo's "First Exchange Offer"

Pengo was carrying on its books a liability of $22,500.00.00 of 8.5% Senior Subordinated Debentures. Pengo was also carrying on its book **accrued but unpaid** interest on the 8.5% Debentures for the three years prior to the "First exchange Offer" for a total of $5,737,500.00.

The Financial Accounting Standards Board ("FASB") has detailed guidelines to compel the issuer and purchaser of **"Zero Coupon"** Bonds to reflect the underlying economic substance of **"Original Issue Discount"**relating to issuing of Zero Coupon Bonds. Accounting Policies Board ("APB") Opinion No. 21 (August 1971) at Par. 12 states:

> "The Note should be recorded at the fair value of the property, goods, or services or at an amount that reasonably approximates the **market value** of the Note, whichever is the more clearly determinable."

As a result of the exchange offer $13,365,000.00 of the 8.5% debentures were

exchanged for **"Zero Coupon"** debentures leaving $9,135,000.00 of the 8.5% debentures outstanding.

After closing of the exchange offer Pengo was required to make the following adjusting entries on their books in accordance with Generally Accepted Accounting Procedures ("GAAP"):

1) Reducing the accrued and unpaid interest liability on the outstanding 8.5% bonds from $5,737,500.00 to $2,329,425.00, **reflecting an extraordinary gain to Pengo.**

2) Reducing the liability associated with the $13,365,000.00 in principal amount of the **"Zero Coupon"** bond that was issue in exchange for the 8.5% bonds to $4,276,800.00 (equal to the market value of the 8.5% bonds that were exchanged at the time of the exchange offer which was

32 cents on the dollar). **Thus reflecting a second extraordinary gain (9,088,200.00)** to Pengo. Pengo was then again required to pay income tax on this "Extraordinary Gain"

3. Charging as an interest expense, **but not paying,** the annual interest on the outstanding **"Zero Coupon"** bonds. This interest is determined by dividing $9,088,200.00 (the extraordinary gain from #2 above) by the number of years from issue to maturity (7.5 years), which equals $1,211,760.00.

Pengo's "First Exchange Offer" had a significant effect on the books of Pengo. Pengo did not have to pay the accrued but unpaid interest on the 8.5% interest on any bond that was exchanged. The interest that did accrue on the Zero coupon bond did not have to be paid until the **"Zero Coupon"** bond matured.

THE COURT SHOULD EXAMINE THE TOTAL EXCHANGE OFFER IN DETERMINING THE CLAIM OF A ZERO COUPON BONDHOLDER

If Pengo in its first exchange offer provided each accepting bondholder $100.00 in cash in addition to the $500.00 Class A and $500.00 Class B "Zero Coupon bonds for each $1,000.00 principal 8.5% bond and two years later Pengo filed bankruptcy, TCNB could not till insist that the **"Zero Coupon"** bondholder's claim was equal to the face amount of the zero coupon bonds. The $100.00 of additional value, or "BOOT" as it is termed by the investment community, must be accounted for in determining the allowed claim of any such bondholder.

Blacks' Law Dictionary, Abridged Fifth Edition, defines the term **"BOOT"**:

> "Cash or other consideration used to balance an equal exchange of two properties; e.g. machine worth $600.00 plus $400.00 cash exchanged for in exchange for another machine worth $1,000.00."

The $400.00 cash is considered "BOOT".

30 Am Jur 2d Section 8 defined the term "Consideration" as relating to an "Exchange of Property" as:

> "The general rules of contract as to the necessity and sufficiency of consideration apply to contract for the exchange of property. In an exchange contract the property received is the consideration for the property given. Cole v. Commissioner (CA8) 140 F2d 636, 151 ALR 1139; Wells v. Houston, 23 Tex Civ App 629 57 SW 584..

Pengo's first "Exchange Offer" provided accepting 8.5% bondholders the following additional consideration "**BOOT**" to induce acceptance of the "Exchange Offer":

a) Shorter maturity; December 1,1991 as opposed to December 1, 1995;

b) Seniority in ranking, the Zero Coupons were Senior Subordinated as compared with the 8.5% debentures being Subordinated debt;

c) Significant reduction in the

conversion price;

Class A convertible at $1.25/sh.
Class B Convertible at $4.50/sh.
8.5% convertible at $32.25/sh..

At the time of the exchange Pengo's stock was selling on the N.Y.S.E. at the time of the exchange for a high of $!.75 and a low of 11/16 (see stipulated fact #10, Appendix D).

Judge Belew in Texstar Corp. v. United States 528 F.Supp 75 (1981) quoted the Fifth Circuit from Gulf, Mobile at 78 where the court stated:

> "As in GM & O, under the exchange offer to the shareholders, **only the debenture holders would get the advantage of a sinking fund**, Apparently, as earlier set out, this was an important distinction to the supreme Court. **This benefit negated the mere substitution of one form for another that "did not create an obligation to pay in excess of an amount previously committed,"** *National Alfalfa*, supra, 417 U.S. at 154, 94 S.Ct. at 2139. **We find it also represented an additional cost for the use of capital."** (emphasis added)

The Fifth Circuit also stated in GM & O 579 F.2d at 900:

> "the market value of the preferred shares is a good yardstick for determining the real issue price of the debentures."

Another District Court within the Fifth Circuit; Southern Fertilizer and Chemical Co. v. Edwards, 167 F.Supp 879, 887 (M.D. Ga. 1955) affirmed a discount after the parties conducted "arm's-length negotiations" to establish the amount of debentures and stock to be exchanged."

a) IMPROVED CONVERTABILITY OF PENGO'S CLASS A&B ZERO COUPON DEBENTURES

In the third quarter of 1984, the time that the Exchange Offer was made, Pengo's common stock had a high of $1.75 and a low of 11/16 per share. A $1,000.00 8.5% debentures could be converted into 31 shares. A $500.00 Class A 0% bond was convertible into 400 shares and a $500.00 Class B 0% bond was convertible into 111.11 shares. The equivalent stock vale of the above three bond at this

time was:

Bond	# of Shrs	Market Value of Shrs (High $1.75)	(Low $0.69)
8.5%	31.00	$ 38.76	$ 21.31
Class A	400.00	$700.00	$240.00
Class B	111.11	$194.44	$ 76.66

Based upon the above high and low price of Pengo's common stock the two (2) bonds had the following stock equivalent values:

Bond	Stock Value High	Low
8.5%	$ 38.76	$ 21.31
Zero %	$894.44	$316.67

This improved convertability was a negotiated inducement "BOOT". Without it 8.5% bondholders would not have exchanged their bonds and Pengo would have been required to file for bankruptcy protection in 1984. The "BOOT" was part of Pengo's quid pro quo (as it believed) avoiding Chapter 11.

If Pengo HAD prospered after the First Exchange Offer its stock would have increased in value and any bondholder who accepted the

exchange offer would have also prospered along with Pengo based upon the reduced convertability of the "Zero Coupon" bonds. The holdout 8.5% bond holders would have only received their interest payment if they were lucky.

Specifically if Pengo stock would have increased to $5.00 per share Pengo's outstanding bonds based upon their equivalent stock value would be worth the following:

Bond	# of Shrs	Stock Value
8.5%	31.00	$ 155.04
Zero %(A&B)	511.11	$2,555.55

The Fifth Circuit erred in ignoring the cognizable financial value of the improved convertability received by those 8.5% bondholders who have accepted Pengo's exchange offer. The Fifth Circuit held simply:

> "... we express no opinion as to whether a fair market value exchange creates OID not allowed under Section 502(b)(2). In a "fair market value exchange," the holders exchange a debt

> instrument for a new debt instrument with a *lower* face amount. In the face value exchange involved in this workout, **Pengo simply exchanged new indebtedness for old indebtedness with the same face amount."** WL 4992.

The two bonds involved in the exchange offer were not the same and did not have the same financial value at the time of the exchange. Therefore, Pengo's "First Exchange Offer" can not be considered an "EQUAL EXCHANGE".

This problem is not unique and will be present in numerous bankruptcy courts in the future due to the large number of recent debt restructuring due to the economic recession. A recent example of this potential problem is Robertson-Ceco Corporation's recent announced "Exchange Offer".

On July 2, 1992 the Wall Street Journal described the Exchange Offer that "Robertson-Ceco Corp. has made which consisted as follows:

> "Robertson-Ceco Corp. Pittsburgh, said it is offering 90% of its stock, plus cash and new debt in exchange for $68.8 million of its 15.5% subordinated debentures.
>
> Under the terms, noteholders would collectively receive 90% of Robertson's 14.5 million shares outstanding stock plus $3 million in cash and $15.5 million principal amount of new unsecured senior notes with interest rates of 10% to 12%."

If the above described exchange offer is implemented and several years later Robertson seeks bankruptcy court's protection is the claim of an accepting bondholder going to be equal to the principal amount of their original debenture or is it going to be based upon the principal and unpaid interest to date of bankruptcy filing less the amount of cash and market value of the stock ("BOOT") that they received at the time of the exchange offer?

If the bankruptcy court follows the Fifth and Second Circuit ruling the bondholder who accepted Robertson's exchange offer would have

a claim equal to the face value of their ordinal bond and the cash and stock that they also received would represent an unearned unjustified windfall profit.

b) REDUCTION OF MATURITY PERIOD

Pengo accelerated the time to maturity of the Zero Coupon bonds so that holders accepting the exchange offer would receive the principal amount four (4) years sooner than the 8.5% bonds would mature. Money has time value. Money paid in hand today is worth more than money paid tomorrow. As set forth supra the rate of return on the **"Zero Coupon"** bond was almost exactly that of the 8.5% bond. This early repayment of such obligation constitutes cognizable value. The accepting bond holder then could make any new investment of his choice.

c) SENIORITY IN RANKING

The Zero Coupon bond was senior in

ranking to the 8.5% bond. The claim of the **"Zero Coupon"** bond would have to be fully satisfied before the 8.5% bondholder were to receive anything if (and when) Pengo entered a bankruptcy proceeding.

WHAT DID THE ACCEPTING BONDHOLDERS KNOW AT THE TIME OF THE EXCHANGE OFFER?

The turning point of the argument as to what is the claim of a Pengo **"Zero Coupon"** bondholder in a subsequent bankruptcy proceeding is: What did the bondholders know at the time of that the exchange offer was in effect?

The answer to this question is contained in Pengo's "Exchange Offering Circular" which advised bondholders on page #26 that states:

> **"Although the New Debentures are non-interest bearing, a portion of any amount received at maturity will be deemed to be interest income. Holders of New Debentures who are United States Persons must report the interest deemed to be received at maturity as interest income."**

On September 11, 1991 the Fifth Circuit granted Licht's motion to amend the record to include page #26 of the "Exchange offering Circular". (see copy of Fifth Circuit's order on page A-32).

Bondholders who accepted the exchange offer knew that although the New Bond had a "Zero Interest Rate" it had imputed interest rate that its owner would receive upon its maturity, and further, the owner would be required to pay income tax each and every year on this imputed interest rate.

THE FIFTH CIRCUIT ERRED WHEN IT STATED THAT THERE WAS NO "OID" CREATED IN PENGO'S FIRST EXCHANGE OFFER

The Fifth Circuit stated at WL4990:

> "Under the rationale of the *Chateaugay* bankruptcy court, the claim of an exchanging holder of a debt instrument in a subsequent bankruptcy proceeding equals not the face amount of the new debt instrument, but the face amount of the new debt instrument *minus* the value paid for the new debt instrument, measured by the unamortized portion of the market value of the old debt instrument on the

exchange date."

The Fifth Circuit then affirmed the District Court decision by stating at WL4992:

> "We strongly disfavor a judicial interpretation of the bankruptcy code that contravenes the substantial Congressional policy favoring out-of-court consensual workouts."

The claim of a Pengo's Zero Coupon bondholder is at best equal to its face amount, $1,000.00, minus the unamortized interest portion based upon the imputed interest rate of 8.5%, the interest rate assumed to be equal to the interest rate of the "Old Debentures" minus the value of the "Boot" received at the time of the exchange.

WILL THE FIFTH CIRCUIT'S AFFIRMATION OF THE DISTRICT COURT'S REVERSAL PROMOTE OR CHILL OUT-OF-COURT DEBT RESTRUCTURING?

The Fifth Circuit stated at WL4992:

> "We strongly disfavor a judicial interpretation of the bankruptcy code that contravenes the substantial Congressional policy favoring out-of-court consensual workout."

However the Fifth Circuit's decision will chill future out-of-court debt restructurings. Any subordinated debt restructuring would require the participation and approval of the Senior/ Secured creditors. Rational Senior/ Secured creditors of a distressed company would refuse to permit the debtor from restructuring it subordinated debt in an out-of-court debt exchange based upon the Fifth Circuit's ruling. The reason is after such a restructuring, if the debtor should then become subject to a bankruptcy proceeding, the subordinated debt holders will in accordance with the Fifth Circuit's decision be able to demand that their bankruptcy claim be based upon the pre-restructure debt instead of their present debt holdings.

The Fifth Circuit stated at WL 4991:

> "Bankruptcy policy strongly favors the "speedy, inexpensive, negotiated" adjustment of creditor-company relations afforded by out-of-court procedures.

> *Chateaugay*,961 F.2d. at 378, 1992 WL 71134 at*4 [citing *In re Colonial Ford* 24 B.R 1014, 1015 (Bankr D. Utah 1982)]. The Bankruptcy Code promotes out-of-court "workouts in the first instance, with refuge in bankruptcy as a last resort.""

This result is clearly illustrated by the conditions specify by Pengo's Senior and Subordinated Secured Lenders to implementation of its Exchange Offer.

As a condition to the debt restructuring, the Senior lenders required Pengo to obtain a specified percentage of its outstanding Subordinated debt to accept its out-of-court "Exchange Offer". Pengo's Senior/ Secured Lenders also agreed to cancel $36,750,000.00 of their debt in exchange for 25% of Pengo's common stock and agreed to exchange their outstanding $72,250,000.00 note for a 7 year "Term Note" in the aggregate amount of $25,750,000.00 bearing interest rate at the greater of 12% or 2% above prime and a 7 year "Supplemental Note" in the aggregate of

$46,500,000.00 with an interest rate of 6%. In addition the Subordinated Secured Lenders agreed to exchange $35,000,000.00 of their 13.5% debentures for Pengo's Convertible Preferred Stock having a liquidation preference equal to $13,000,000.00.

Based upon the Fifth Circuit's ruling, the Senior Secured Lenders in a bankruptcy proceedings would have no claim for their $36,750,000.00 debt forgiven and the Subordinated Secured Lenders would also have no claim based upon their original $35,000,000.00 debenture that they exchanged into preferred stock in the out-of-court restructuring. The Zero Coupon bondholder's claim, on the other hand, would be based upon the face value of their original bonds, unreduced by **unmatured interest** and by the **"BOOT"** that the Zero Coupon bondholders received in the exchange offer.

Consequently if the Fifth Circuit's judgement is allowed to stand it will terminate any and all future out-of-court debt restructuring because no senior lender would ever agree to an out-of-court restructuring in which the subordinated lenders would be restored to their original position and the Senior Lenders claim would be based upon their new equity restructured position.

FIFTH CIRCUIT'S RULING CONFLICTS WITH THE NINTH CIRCUIT RULING IN NUCORP ENERGY SECURITIES LITIGATION

The Ninth Circuit in Nucorp Energy determined that a claim for damages in a security litigation belongs to the party that was actually damaged and not to a subsequent purchaser. If the security is subsequently sold unless the claim is specifically included in the sale the claim remains with the damaged party.

In Nucorp Energy at 1493 the Ninth

Circuit stated;

> "**If causes of action were automatically transferred, defendants could be subject to double liability, and the transferee would recover damages even though they had suffered no injury, while the injured transferors would recover nothing.** Accordingly, we conclude that under New York law the Phelps Committee did not acquire the New York cause of action when they acquired the securities. The Phelps Committee's State claims must be dismissed." (Emphasis added)

In the Pengo case the Fifth Circuit stated that the claim of all "Zero Coupon" bondholders was equal to the face amount of the bond regardless of how and when they obtained their bonds. This ruling contradicts the Ninth Circuit's holding in Nucorp.

The question of automatic assignment of a claim was also recently dealt with by Judge William Browning in re Washington Public Power Supply System Securities Litigation MDL551 ("WPPSS") which was affirmed on appeal by the Ninth Circuit. (see copy of order attached in Appendix E)

Judge Browning dismissed the federal claims of bondholders who purchased their bonds in the secondary market after the Washington Supreme Court ruled that the "Take or Pay" agreement entered into by the 88 utilities was invalid.

To allow a present holder of Pengo's 0% bonds to assert a claim equal to the face value of their bonds regardless of when they purchased their bonds is in direct contradictions of both Nucorp and WPPSS court's rulings.

REASONS FOR GRANTING THE WRIT

The Court should grant Certiorari to determine an important question of law that has not been answered by either the Fifth Circuit in the case at bar or the Second Circuit in Chateaugay 961 F.2d 378. Further more the rulings of the Fifth and Second circuit are clearly contrary to the National/

Congressional interest to favor "Out of Bankruptcy Court Restructuring". The Supreme Court is needed to provide guidelines to the bankruptcy courts in light of the numerous out-of-court debt restructuring and prearranged bankruptcy proceedings taking place.

The questions are when an out of bankruptcy debt for debt plus "Boot" exchange offer is made:

a) Should the value of the additional consideration "**BOOT**" received at the time of the exchange be used to reduce the claim of an accepting bondholder in a subsequent bankruptcy proceeding?

b) If the new debt issued by a debtor in a bond for bond exchange has an interest rate significantly below market rates at the time of the exchange offer, should the claim of the bondholder in a

subsequent bankruptcy proceeding be reduced by the "Unmatured Interest" associated with the new bond?

These questions have not been squarely addressed to date.

Guidelines are necessary for the Bankruptcy courts so that each claim can be evaluated properly and eliminate the cost and time consumption in the appeal process.

Both Pengo and Chateaugay decision fails to provided the needed direction.

To permit the **"Zero Coupon"** bondholders a claim equal to the face value of their bond disregarding when and how they obtained their bonds is inconsistent with previous court's ruling. The Ninth Circuit has spoken out load and clear regarding this type of profit stating that this was not the intent of Congress.

CONCLUSION

If this Fifth Circuit's decision is allowed to stand the ability to consummate out-of-court debt restructuring will diminish. After an out-of-court debt restructuring if the debtor is forced to seek bankruptcy court protection, all of the creditors who accepted the exchange offer would assert claims based upon their original position. This gives accepting creditors in a voluntary exchange in a bankruptcy two (2) bits of the apple at the expense of the debtor and all other creditors and parties in interest not similarly situated.

By refusing to consider the value of the **"BOOT"** Pengo's "Zero Coupon" bondholders received, the Fifth Circuit has given those bondholders who have accepted the Exchange Offer a windfall profit in violation of the Ninth Circuit ruling in Nucorp Energy and has effectively would chilled other corporations

in financial difficulty from restructuring out of bankruptcy.

Since there is no such thing as a "ZERO INTEREST" loan, ever "**Zero Coupon**" bond by its very nature has unmatured interest associated with it from the date of the bankruptcy filing up to the date of its maturity. To allow a "Zero Coupon" bondholder to have a claim in a bankruptcy proceeding equal to the face (matured) amount of the bond prior to the date of maturity is a direct violation of Title 11 Section 502(b)(2) of the Bankruptcy Code.

The Supreme Court should require that the claim of a "Zero Coupon"bondholder be reduced by an amount equal to the "**Unmatured Interest**" for the period from the bankruptcy petition to the maturity date of the zero coupon bond and further reducing the allowed claims by the present value of the "Boot" received at the

time of the exchange.

WHEREFORE since there are significant conflicts between the Fifth Circuit's order relating to Pengo's Zero Coupon bondholders' claims in bankruptcy with the Supreme Court ruling in National Alfalfa and other circuits previous orders Petitioner respectfully prays that this Honorable Court grant this petition and reverse the Fifth Circuits Order affirming the District Court's reversal of the Bankruptcy Court's order that sustained the Petitioner's objection to the claims of TCNB claim.

Respectfully submitted;
DR SEYMOUR LICHT P.E.
14002 North 67th place
Scottsdale, Arizona 85254
(602) 948-1173.

NO.

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IN THE

SUPREME COURT OF THE UNITED STATES

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OCTOBER TERM, 1992

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DR SEYMOUR LICHT P.E.

Petitioner

vs.

TEXAS COMMERCE BANK ET AL

Respondents

APPENDIX

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR WRIT OF CERTIORARI

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DR SEYMOUR LICHT P.E.
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Petitioner
Pro. se.

APPENDIX A
Opinion/ Order of the
Fifth Circuit Court of
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Pengo Industries" 6/12/92 . . . A-1 to 34

Fifth Circuit's Order
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APPENDIX C
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APPENDIX E
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APPENDIX F
Supreme Court Local Rules . . F 1 to 2

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In the Matter of PENGO INDUSTRIES INC.,
Pengo Finance N.V. , Debtors

v.

Dr Seymour Licht, and Official
Committee of Unsecured Creditors
of Pengo Industries, Appellants

No. 91-1769

June 12, 1992

Unsecured creditors objected to claim submitted by debenture holders in Chapter 11 case. The Bankruptcy Court, Massie M. Tillman, J., sustained objection. Appeal was taken. The United States District Court for the Northern District of Texas, John H. McBryde, J., 129 B.R. 104, reversed. Unsecured creditors appealed. The Court of Appeals, Goldberg, Circuit Judge, held that: (1) any unamortized original issue discount (OID) created by debt-for-debt exchange represents "unmatured interest," a disallowable

claim in Chapter 11 case, and (2) debt-for-debt face value exchange in consensual workout did not create original issue discount so as to make claim disallowable as unmatured interest in Chapter 11 case.

District Court affirmed.

1. Bankruptcy (Key)2835

Unamortized original issue discount (OID) is disallowable as unmatured interest in Chapter 11 case. Bankr.Code, 11 U.S.C.A 502(b)(2).

2> Bankruptcy (Key)2835

Debt-for-debt face value exchange in consensual out-of-court restructuring did not create "unmatured interest," inform of original issue discount (OID), within meaning of Bankruptcy Code provision disallowing claims for unmatured interest. Bankr. Code, 11 U.S.C.A. 502(b)(2).

See publication Words and Phrases for other judicial constructions and definitions.

Appeals from the United States District Court

for the Northern District of Texas.

Before GOLDBERG, DUHE, and BARKSDALE, Circuit Judges.

GOLDBERG, Circuit Judge:

A company finds itself unable to meet its debt obligations. Its bondholders fear bankruptcy, with its inherent delays, cost, and complications. But perhaps the company can work out its financial problems before capitulating to the bankruptcy courts. The company proposes an exchange: Bondholders can tender an old bond and receive a new bond of equal face value, but on terms more favorable to the company. The incentive for the bondholder is two-fold: an increased likelihood that the company can meet its obligations on the new bonds and the avoidance of bankruptcy proceedings. Although many bondholders do exchange their old bonds, the company nevertheless lands in bankruptcy court. The issue then becomes the amount of the new bondholder's claim against the debtor: Is it

the full face value of the new bond or is it some lesser, discounted amount reflecting the fair market value of the old bond at the time of the exchange?

This particular query has fascinated not only creditors of companies engaging in consensual workouts, but also bankruptcy commentators and practitioners: Whether a face value exchange of debt instruments in a consensual out-of-court workout creates original issue discount that constitutes unallowable "unmatured interest" under section 502(b)(2) of the Bankruptcy Code. We affirm the district court and hold that such an exchange does not generate "unmatured interest."

I. BACKGROUND

The Pengo companies manufacture equipment for the petroleum industry, explosives, rubber products and earth-boring augers and teeth. In late 1988 and early 1989, involuntary petitions for relief under Chapter 11 of the Bankruptcy

Code were filed against Pengo Industries, Inc. and its subsidiary, Pengo Finance, N.V. (collectively, "Pengo") The Official Unsecured Creditors Committee and Dr. Seymour Licht, an individual creditor, objected to two proofs of claim filed by Texas Commerce Bank National association ("TCBNA") on behalf of the holders of two securities, the Class A and Class B debentures. TCBNA served as indenture trustee for holders of Class A and Class B debentures.

Back in 1980, Pengo Finance issued $22,500,000 of 8 1/2% convertible debentures due in 1995. The public purchased these Old Debentures for the full face amount of $1,000 each. Neither Pengo Finance, nor Pengo, the guarantor, could make interest payments to the Old debenture holders in 1983. Pengo merely accrued the interest expense on its books. Several years later, in 1985, a standstill agreement between Pengo and its senior secured lenders required an exchange offer as part of an

out-of-court workout designed to enable Pengo to restructure its indebtedness. In the First Exchange Offer, Pengo Finance offered to exchange one 0% $500 face amount Class A debenture and one 0% $500 face amount Class B debenture for each 8 1/2% $1,000 face amount Old Debenture. Each participating Old Debenture holder received two New Debentures with a total face value of $1,000 for each of their Old Debentures with a face value of $1,000. The Old Debentures were subordinated to payment in full of the New Debentures. And, while the Old Debentures mature in 1995, the New Debentures matured in 1991. The Old Debentures could be redeemed for Pengo's common stock at a much less favorable rate than that for the New Debentures. About $13,205,000 of the Old Debentures-58.7% of the issue-were exchanged for the same face amount of New Debentures. Although holders of the New Debentures waived the payment of past due interest on the Old Debentures, Pengo

remained in default on the Old Debentures outstanding after the exchange because it continued to fail to make interest payments.

The reorganization plan placed all unsecured creditors into a single class, which included holders of both Old and New Debentures. Those creditors will share in a limited distribution. Since the total claims of the unsecured creditors exceed the amount of the limited distribution, the amount of the New Debenture holders' claims directly alters the funds available to all other unsecured creditors.

The two proofs of claim filed by TCBNA on behalf of the holders of Class A and Class B debentures in the Pengo bankruptcy represented the full face amount of the outstanding New Debentures. TCBNA did not deduct any amount for unamortized original issue discount. The Committee and Dr. Licht, who holds Old Debentures, objected to the amounts of the claims, arguing that the exchange created

unamortized original issue discount and, thus, a portion of the claims constituted "unmatured interest" not allowable under 11 U.S.C. 502(b)(2).[1]

After a hearing and upon stipulated facts, the bankruptcy court sustained the objections and reduced the New Debenture holders' two proofs of claim to eliminate what the court considered to be unamortized original issue discount-unmatured interest under section 502(b)(2). The district court reversed the bankruptcy court and held that the proofs of claim did not include a claim for original issue discount. *Texas Commerce Bank Nat'l Ass'n v.*

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[1] Section 502(b)(2) provides in relative part that

if such objection to a claim is made [under Sect. 502(a)], the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that-(2) such claim is for unmatured interest.

11 U.S.C. Sect. 502(b)(2) (Supp. 1991)

Licht (In re Pengo Indus., Inc.) 129 B.R. 104 (N.D.Tex.1991)[2]. The Committee and Dr. Licht appeal from the judgment of the district court reversing the judgment of the bankruptcy court. We review the bankruptcy court's conclusion of law *de novo*. *Stoker v. Smith (In re Moody)*, No. 91-2156, Slip op. 4091, 4092, - F.2d-,-,-(5th Cir. apr. 29, 1992) (*citing Jordan v. Southeast Nat'l Bank (In re Jordan)*, 927 F.2d 221, 224 (5th Cir.1991)).

II. DISCUSSION

A. "Unmatured Interest" and Original Issue Discount.

[1] Section 502(b) of the Bankruptcy Code requires the bankruptcy court to determine the amount of a claim objected to by a party in interest under section 502(a). Congress has provided specific standards to guide the

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[2] The district court opinion contains all the stipulated facts. For an exhaustive rendition of the events involved in this dispute, see *Pengo*, 129 B.R. at 105-08.

bankruptcy court in making this determination. 11 U.S.C. 502(b)(1)-(8) (1979 & Supp.1991). One established statutory rule is that the bankruptcy court must disallow any claim "for unmatured interest." 11 U.S.C. 502(b)(2) (Supp. 1991). This rule flows from the legal principle that "interest stops accruing at the date of the filing of the petition." S.Rep. No.989,95th Cong., 2d Sess. 63, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5849.

In this case, the bankruptcy rule meets an economic acronym: OID. OID-original issue discount- presents a definitional concept generally unfamiliar to those not bonded to the world of economics. As ably explained by the Second Circuit, "[o]riginal issue discount results when a [debt instrument] is issued for less than its face value. The discount, which compensates for a stated interest rate that the market deems too low, equals the difference between a [debt instrument]'s face amount

(stated principal amount) and the proceeds, prior to issuance expenses, received by the issuer." *LTV Corp. v. Valley Fidelity Bank & Trust Co. (In re Chateaugay Corp.)*, No. 91-5098,_ F.2d_,_ 1992 WL 71134,at *2 (2nd Cir. Apr. 13, 1992); *see* Marc S. Kirschner, Dan A. Kusnetz, Laurence Y. Solarsh & Craig S. Gatarz, *Prepackaged Bankruptcy Plans: The Deleveraging Tool of the '90's in the Wake of OID and Tax Concerns*, 21 Seton Hall L.Rev. 643, 648-50 (1991) [hereinafter *Deleveraging Tool]; see also* Nicholas P. Saggese, Gregg A. Noel & Michael E. Mohr, A *Practitioner's Guide to Exchange Offers and Consent Solicitations*, 24 Loy. L.A. L.Rev. 527,548 n. 100(1991)("[A] debt security is issued with OID to the extent its stated redemption price at maturity exceeds its issue price.") [Hereinafter *Practitioner's Guide*]. The discount on a debt instrument, deduced from a purchase price lower than the face value of the instrument, "is 'in the nature of additional

interest.'"*Deleveraging Tool, supra*, at 649 & n. 28 (citations omitted). The borrower amortizes the OID, "for accounting and tax purposes, over the life of the [debt instrument]," then the company pays back the face value to the holders on the maturity date. *Chateaugay*, _F.2d at _, 1991 WL 71134, at *2.

The "unmatured interest" bankruptcy rule and the economic notion of "original issue discount" intersect to form the legal nexus for our decision-making. The term "unmatured interest," which is not defined by the Bankruptcy Code, encompasses OID. The economic reality of original issue discounting bolsters this conclusion. Chateaugay, _F.2d at _, 1992 WL 71134, at *2 ("As a matter of economic definition, OID constitutes interest.") (citations omitted). For OID constitutes a "method of providing for and collecting what in economic fact is interest to be paid to compensate for the delay and risk involved in

the ultimate repayment of monies loaned."*In re Public Serv. Co.*, 114 B.R. 800, 803 (Bankr.D.N.H.1990). Moreover, the legislative history verifies our inclusion of OID in the category of unallowable "unmatured interest." The Senate and House Reports both state and "[i]nterest disallowed under [502(b)(2)] includes post petition interest that is not yet due and payable and any portion of prepaid interest that represents an original discounting of the claim, yet that would not have been earned on the date of bankruptcy." S.Rep. NO.989,95th Cong., 2d Sess. 62, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5848; H.R.Rep. No. 595, 95th Cong., 2d Sess. 352 *reprinted in* 1978 U.S.C.C.A.N. 5963, 6308. Since Congress considered unamortized OID "the economic equivalent of 'unmatured interest,'" we agree with both the bankruptcy court and the district court in concluding that any unamortized OID created in the Pengo exchange represents a

disallowable claim in bankruptcy under section 502(b)(2). *Deleveraging Tool, supra*, at 650; *see Chateaugay*,-F.2d at_, 1992 WL 71134, at *2 ("[C]ourts that have considered the issue under section 502(b)(2) have held that unamortized OID is unmatured interest and therefore unallowable as part of a bankruptcy claim.") (citations omitted).

B. The Debt-for-Debt Face Value Exchange.

[2] The 1980's spawned trouble-trouble for companies encumbered by massive amounts of debt. Not surprisingly, this crisis has fused into "an explosion of debt defaulted, out-of-court debt restructuring and bankruptcies." *Deleveraging Tool, supra*, at 643. A company confronted with debt default can choose to rearrange its finances out of court as an alternative to obtaining relief under the bankruptcy laws.

> A debtor in financial trouble may seek to avoid bankruptcy through a consensual out-of-court workout. Such a recapitalization,

> when it involves publicly traded debt, often takes the form of a debt-for-debt exchange, whereby bondholders exchange their old bonds for new bonds. The debtor hopes that the exchange, by changing the terms of the debt, will enable the debtor to avoid default. The bondholders hope that by increasing the likelihood of payment on their bonds, the exchange will benefit them as well. The debtor and its creditors share an interest in achieving a successful restructuring of the debtor's financial obligations in order to avoid the uncertainties and daunting transaction costs of bankruptcy.

Chateaugay,-F.2d at-, 1992 WL 71134, at *3. The Pengo exchange offer, like that in *Chateaugay*, constituted a "face value exchange," for Pengo simply substituted "new indebtedness for an existing debenture, modifying terms or conditions but not reducing the principle amount

of the debt." ID.; *see Deleveraging Tool, supra*, at 646.[3] Pengo, as would any other offerer of a face value exchange, obtained "more time to recover from its financial problems," *Deleveraging Tool, supra*, at 646, but "remain[ed] fully liable for the original funds borrowed." *Chateaugay*, - F.2d at -, 1992 WL 71134, at *3.

The 1989 bankruptcy court decision of *In re Chateaugay* created an enormous disincentive for investors to participate in consensual out-of-court restructuring and, thus, spurred movement of financially troubled companies into the bankruptcy courts. *LTV Corp. v. Valley Fidelity*

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[3] This case differs from *Chateaugay* in one respect. *Chateaugay* the old debentures were originally issued at a discount. Because the original discount carried over from the old debt to the new debt, the Second Circuit found OID on the new debt, although no new OID was created by the face value debt-for-debt exchange. *Chateaugay*, --- F.2d at---, 1992 WL 71134, at *6. Here, the Old Debentures were not issued at a discount; we confine our analysis to whether the exchange of the Old Debentures for New Debentures generated OID.

Bank & Trust Co. (In re Chateaugay Corp.), 109 B.R. 51(Bankr.S.D.N.Y.1990), *aff'd*, 130 B.R. 403(S.D.N.Y.1991), *aff'd in part and rev'd in part*, No. 91-5098,-F.2d-,1992 WL 71134(2nd Cir. Apr. 13,1992). Before we explain why we choose not to follow the rule formulated by the *Chateaugay* bankruptcy court and urged by Appellants and, instead, adopt the rule of the *Chateaugay* court of appeals, we pause to further highlight the context of the *Chateaugay* and *Pengo* debt-for-debt value exchange offers. The legislative history to section 502 supplies an example of how the pre-bankruptcy issuance of a note for cash generates OID: "[A] claim on a $1,000 note issued the day before bankruptcy would only be allowed to the extent of the cash actually advanced. If the original discount was 10 percent so that the cash advanced was only $900, then notwithstanding the face amount of note, only $900 would be allowed." S.Re. No. 989, *reprinted in* 1978 U.S.C.C.A.N. at 5848;

H.R.Rep. No. 595, *reprinted* in 1978 U.S.C.C.A.N. at 6308. In the illustration, the debtor issued a note *for cash*, while in *Chateaugay* and *Pengo* the debtor issued the debt instruments as part of the *exchange* of debt securities. *See Practitioner's Guide, supra*, at 550 n. 108. Although we conclude that the statutory rule excludes original issue discount to "prevent creditors from claiming *disguised, unearned interest*"- *regardless* of context- the legislative history simply does not provide guidance to courts considering section 502(b)(2) objections based on the notion of OID in the context of an exchange in a consensual out-of-court workout. *Id.* (emphasis in original):P *see* Gary b. Wilcox & David M. Rievman, *Restructuring Troubled Debt Under the New Debt Exchange Rules*, 10 VA. Tax Rev. 665, 669 n. 28 (1991) [hereinafter *Restructuring*].

The *Chateaugay* bankruptcy court, then, faced a narrow issue, but one of national first

impression: Whether a face value exchange of debt instruments in a consensual out-of-court workout generated original issue discount not allowed under section 502(b)(2). In *Chateaugay* the LTV Corporation offered to exchange $1,000 face amount of new 15% senior notes and shares of common stock for each $1,000 face amount of old 13 7/8% debentures. After the face value exchange in *Chateaugay*, LTV filed the Chapter 11 protection. The indenture trustees filed proofs of claim for the face value of the new notes. The bankruptcy court first held, as we do, that unamortized OID constituted "unmatured interest" under section 502(b)(2). *Chateaugay*, 109 B.R. at 55. The court also held, however, that the *exchange* represented the issuance of *new debt* because "[m]aturity dates, interest rates, and sinking fund requirements have all been changed in the New Notes." *Id.* at 56. According to the *Chateaugay* bankruptcy court, LTV issued the new notes at a discount gauged by the difference

between the face amount of the new notes and the value paid for the new notes. The court reasoned that the fir market value of the "property given up in the exchange transaction"-the old debentures-constituted the proper measure of the issue price of the new notes.[4] *Id.* at 58 (holding that unamortized OID on the new notes could not be resolved on motion for summary judgment because dispute existed as to the value of the old debentures on the exchange date).

The Committee and Dr. Licht urged this Court to endorse the *Chateaugay* bankruptcy court's analysis and hold that the Pengo exchange created OID measured by the difference between the face amount of the New Debentures and the value given for the New Debentures, measured by the unamortized portion of the fair market value of the Old debentures on the exchange date. The

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[4] The court disregarded the value of the acquired stock in determining the value of the new notes; it compared the exchanged debentures with the acquired debt.

Chateaugay decision, however, produced a swift response from commentators who aggressively scrutinized its analysis of the original issue discount question in the face value exchange context and observed its effect on consensual out-of-court restructuring. *See Deleveraging Tool, supra*, at 647-48; Richard L. Epling, *Exchange Offers, Defaults, and Insolvency: A Short Primer*, Bankr.Devs.J. 15, 42-47 (1991) [hereinafter *Primer*]; *Practitioner's Guide, supra*, at 548-51; *Restructuring*, supra, at 669 n. 28. This is so because the decision translated, in general terms, into the rule that when a financially troubled company exchanges new debt for old debt of equal face value, exchanging holders "will have a lower claim than those who did no [exchange], even though the overall debt obligation of the company has not been altered." *Deleveraging Tool, supra*, at 647. Under the rationale of the *Chateaugay* bankruptcy court, the claim of an exchanging holder of a

debt instrument in a subsequent bankruptcy proceeding equals not the face amount of the new debt instrument, but the face amount of the new debt instrument *minus* the value paid for the new debt instrument, measured by the unamortized portion of the market value of the old debt instrument on the exchange date. For example, if we were to follow the *Chateaugay* bankruptcy court rule in this case, the claims of the exchanging holders of New Debentures would not be $1,000, the face amount of the New Debentures but about $680, the face amount of the New Debentures ($1,000) minus the unamortized OID (approximately $320). This illustration makes it quite understandable that creditors of financially troubled companies are eager for the courts to provide them with guidance as to the post-bankruptcy ramifications of their workout decisions.

Until one month ago, the bankruptcy court's decision in *Chateaugay* represented the only

school of judicial thought on the issue of whether a debt-for-debt face value exchange in a consensual out-of-court restructuring generated "unmatured interest" within the meaning of section 502(b)(2). But the *Chateaugay* bankruptcy and district court decisions did not reveal the complete interpretive scenario. A unanimous panel of the Second Circuit recently reversed the *Chateaugay* district court's judgment affirming the bankruptcy court and held, *inter alia*, that a face value exchange of debt obligations in a consensual workout does not generated OID. *Chateaugay*,-F.2d at-,1992 WL 71134, at *5. This holding injected a new theory of OID into the bankruptcy jurisprudence. The legal landscape eloquently pictured by the Second Circuit persuades us that like the LTV exchange, the debt-for-debt face value exchange in the Pengo consensual workout did not create original issue discount for purposes of section 502(b)(2). We discuss the factors that support

our holdings.

1. The Debt-for-Debt Face Value Exchange and Section 502(b)(2).

Bankruptcy policy strongly favors the "speedy, inexpensive, negotiated' adjustment of creditor-company relations afforded by out-of-court procedures. *Chateaugay*,-F.2d at -, 1992 WL 71134, at *4 (citing *In re Colonial Ford*, 24 B.R. 1014, 1015 (Bankr.D.Utah 1982)) The Bankruptcy code promotes out-of-court "workouts in the first instance, with refuge in bankruptcy as a last resort." *Id. (citing Colonial Ford*, at 1015). *See generally Colonial Ford*, 24 B.R. at 1015-17 (extensively detailing the advantages of out-of-court workouts and explaining how the Code favors such restructuring). We endorse the reasoning of the Second Circuit, which aims to align the resolution of the OID issue with this bankruptcy policy. If the exchange of debt generate OID for the purposes of section 502(b)(2), "then creditors will be disinclined

to cooperated in a consensual workout that might otherwise have rescued a borrower from the precipice of bankruptcy." *Id.* A rule that a debt-for-debt face value exchange in a consensual out-of-court workout creates OID concomitantly reduces the likelihood that creditors will "cooperate with a struggling debtor" because such a rule lowers the exchanging creditors' claims in bankruptcy. *Id.* Creditors faced with the choice of either refusing to exchange or accepting the exchange offer would certainly realize that if they choose to exchange, their claim in a subsequent bankruptcy proceeding would shrink by the amount of unamortized OID. *Primer, supra,* at 44 & n. 178 ("The financial press has noted this development with some dismay."). This creditor awareness would surely translate into "fewer out-of-court debt exchanges and more Chapter 11 filings." *Chateaugay*,-F.2d at -, 1992 WL 71134, at *4.

Such a rule also would "grand[] a ... windfall ... to holdouts who refuse to cooperate." *Id.* (citation omitted). The resulting dynamic is not difficult to prophesy. As the exchanging creditor' claim to a piece of the distributional pie shrinks, the corresponding portion of the pie actually recovered by the holdouts grows. *Practitioner's Guide, supra,* at 549-50 & n. 106. Since a rule recognizing the creation of OID in the context of a debt-for-debt face value exchange not only penalizes the exchanging creditors by revaluing their claims downward, but also regards the non-exchanging holdouts by increasing the chance of receiving the total amount of their fully-intact claims. it "gives creditors a *disincentive* to cooperate with a struggling debtor." *Deleveraging Tool, supra,* at 658 (emphasis in original); see *Practitioner's Guide, supra,* at 549. We strongly disfavor a judicial interpretation of the Bankruptcy Code that

contravenes the substantial Congressional policy favoring out-of-court consensual workouts. We hold, therefore, that the debt-for-debt face value exchange in the Pengo consensual out-of-court restructuring did not create "unmatured interest" in the form of original issue discount under section 502(b)(2) of the Bankruptcy Code.

2. Distinguishing Inapposite Scenarios.

As heretofore discussed, we decide only the narrow issue of whether a debt-for-debt face value exchange generates OID not allowed under section 502(b)(2). The parties offer cases and arguments discussing OID in contexts other than the one presented by the facts of this cse. In closing, we think it is important to briefly state what this case is *not* about. First, we decline to consider when an *original* issue of debt might create a discount and instead, appropriately confine our decision to whether the *exchange* of debt instruments in a consensual out-of court restructuring creates a discount.

See *supra* slip opinion page 4989 (contrasting how OID can arise when a debtor issues a debt instrument for an amount less than its face value with the suggestion that OID is generated when a debtor exchanges a debt instrument for another debt instrument of equal face value in a consensual out-of-court workout).

Next, we express no opinion as to whether a fair market value exchange creates OID not allowed under 502(b)(2). In a "fair market value exchange," the holders exchange a debt instrument for a new debt instrument with a *lower* face amount. In the face value exchange involved in this workout, Pengo simply exchanged new indebtedness for old indebtedness with e same face amount.

We also refuse to investigate debt-for-stock exchanges and merely consider the debt-for-debt exchange presented by the facts of this case. In reducing the claims of the New Debenture holders, the bankruptcy court relied on *In re*

Allegheny Int'l, Inc., 100 B.R. 247 (Bankr.W.D.Pa.1989). That case, however, concerned a pre-bankruptcy debt-for-equity swap, not a debt-for-debt exchange. Allegheny offered to exchange new debentures for old preferred stock. *Id.* at 248. Since the equity holders merely "had an *interest* in, but not a claim against" the debtor prior to the exchange, commentators have suggested that the exchange constituted on *original* issue of debt that created not only a claim against the debtor, but also a discount. *Deleveraging Tool, supra,* at 654 n. 43 (emphasis in original); *see Practitioner's Guide, supra,* at 549 n. 103 ("stockholder who exchanges his outstanding stock for debt has elevated his status to that of creditor"); *Primer, supra,* at 43 ("debentureholders had stepped up from an equity position as a result of the exchange"); *Restructuring, supra,* at 669 n. 28 ("preferred stockholders were elevated to creditor status").

We emphasize, as did the Second Circuit in *Chateaugay*, that we need not decide the distinct issue of whether OID arises from a debt-for-equity exchange. *Chateaugay*, -f.2d at-, 1992 Wl 71134, at *5 (noting that debtor Allegheny's balance sheet reflected an increase in overall liabilities after the debt-for-equity exchange).

Finally, this is not a tax case. We stress that the tax treatment of original issue discounting does not control our inquiry, which is placed firmly within the bankruptcy framework. The Second Circuit firmly rebuked the *Chateaugay* bankruptcy court for its reliance on tax cases for the proposition that a debt-for-debt exchange offer in a consensual out-of-court restructuring generates OID. *Id.*-f.2d at-,-,1992 Wl 71134 at *5. While we might consider the tax treatment of a transaction persuasive authority in determining the bankruptcy treatment of that transaction, the tax rules applicable to a

transaction certainly do not circumscribe those devised in bankruptcy. *Chateaugay*, _F.2d at _, 1992 WL 71134, at *5 (citations omitted); *Deleveraging Tool,supra*, at 655 & n. 46 (citations omitted). The bankruptcy system revolves around the policy that all creditors who are similarly situated are entitled to fair and equitable treatment. *Deleveraging Tool, supra*, at 655 & 660 n. 56. The tax system, however, usually requires that whenever a "realization event" has occurred and the taxpayer can measure the amount of realizable gain or loss, the taxpayer must include the consequences of that transaction in calculating the taxpayer's income. *Id.* at 656. Just because an exchange offer may constitute a realization event justifying the taxation of the participants, it does not follow that the transaction demands a corresponding transformation in the relationship of similarly situated creditors. Chateaugay,_F.2d at-, 1992

Wl 71134, at *5; *Deleveraging Tool, supra* at 656. As bluntly stated by the Second Circuit, the reasoning underlying the tax treatment of debt-for-debt exchanges "simply does not apply in the bankruptcy context."[5] *Chateaugay* - F.2d at-,1992 Wl 71134,at *5. Especially when polestar bankruptcy policy militates against doing so, we do not feel compelled to interpret the Bankruptcy Codes so as to parallel the tax rules for a transaction.

III. CONCLUSION

For the foregoing reasons, we **AFFIRM** the judgment of the district court.

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[5] The parties quarrel over whether this Court should consider certain statements contained in the Offering circular about the reporting of interest income by holders of the New Debentures. We need not reach the issue of whether these statements are properly before this Court. Even if we resolve that issue affirmatively, we repeat that the treatment of a transaction does not determine its treatment in bankruptcy.

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1769

In the Matter of PENGO INDUSTRIES INC.,
Pengo Finance N.V. ,
Debtors

TEXAS COMMERCE BANK, N.S., Indenture Trustee,
Appellee

versus

Dr Seymour Licht, and Official
Committee of Unsecured Creditors
of Pengo Industries, Appellants

Appeal from the United States District Court for
the Northern District of Texas

O R D E R:

IT IS ORDERED that the motion of appellant Licht to include in the record on appeal excerpts from Debtor's exchange offering circular is **GRANTED**.

IT IS FURTHER ORDERED that the alternative motion of appellant Licht to take judicial notice of the First Exchange offer in its review

of the District Court's reversal of the bankruptcy Court's Decision is DENIED AS MOOT.

E. Grandy Jolley

UNITED STATES CIRCUIT JUDGE

(Filed on September 11, 1991)

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-1769

In the Matter of PENGO INDUSTRIES INC.,
Pengo Finance N.V. ,
Debtors

TEXAS COMMERCE BANK, N.S., Indenture Trustee,
Appellee

versus

Dr Seymour Licht, and Official
Committee of Unsecured Creditors
of Pengo Industries, Appellants

Appeal from the United States District Court for
the Northern District of Texas

ON PETITION FOR REHEARING

(July 10, 1992)

Before GOLDBERG, DUHE, and BARKSDALE, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and

numbered cause be and the same is hereby DENIED.

ENTERED FOR THE COURT:

_____
IRWIN L. GOLDBERG
United States Circuit Judge

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

IN RE	)	
	)	
PENGO INDUSTRIES, INC.	)	
AND PENGO FINANCE, N.V.	)	
	)	
Debtor	)	
	)	
	)	
TEXAS COMMERCE BANK	)	
NATIONAL ASSOCIATION	)	
	)	CIVIL ACTION
Appellant	)	NO. CA-90-238-A
	)	
VS	)	
DR SEYMOUR LICHT AND THE	)	
OFFICIAL UNSECURED	)	
CREDITORS COMMITTEE	)	
	)	
Appellee	)	
	)	

MEMORANDUM OPINION
and
ORDER

This action comes before the court as an appeal from an order entered by the United States Bankruptcy Court, Northern District of Texas, Fort Worth Division, the Honorable Massie Tillman presiding. The court, having reviewed

the briefs of appellant, Texas Commerce Bank National Association ("TCBNA") and appellees, Dr. Seymour Licht ("Licht") and the Official Unsecured Creditors Committee ("Committee"), the record on appeal and applicable authorities, has determined that the bankruptcy court's order sustaining objections to claim of TCBNA should be reversed.

Jurisdiction

This is an appeal from an order of the bankruptcy court reducing the claims of the holders of Class A and Class B Non-Interest Bearing Senior Subordinated Guaranteed Debentures due in 1991 ("Class A and Class B Debentures") on the ground that they were issued at a discount and that the claims therefore included additional interest which could not be allowed. This court's jurisdiction exists pursuant to 28 U.S.C. 158(a).

Underlying Facts and Proceedings

The underlying case was presented to the

bankruptcy court on stipulated facts as follows:

1. TCBNA is the Indenture Trustee with respect to the Class A Non-Interest Bearing Convertible Senior Subordinated Guaranteed Debentures due in 1991 ("Class A Debentures") and Class B Non-Interest Bearing Convertible Senior Subordinated Debentures due in 1991 ("Class B Debentures"), both issued by Pengo Finance, N.V. ("Finance") and guaranteed by Pengo.

2. TCBNA filed a proof of claim with respect to the Class A Debentures in the amount of $4,552,000, representing the full face amount of the Class A Debentures allegedly outstanding as of the date of the filing of Pengo's involuntary bankruptcy petition ("Petition Date").

3. TCBNA filed a proof of claim with respect to the Class B Debentures in the amount of $5,439,500, representing the full face amount of the Class B Debentures allegedly outstanding as of the Petition Date.

4. Licht, a holder of 8-1/2% Debentures, duly objected to the two claims filed by TCBNA for the full face amount of the Class A Debentures and Class B Debentures.

5. The Committee duly objected to the two claims filed by TCBNA for the full face amount of the Class A Debentures and Class B Debentures.

6. Subsequently, TCBNA filed an amended claim with respect to the Class A Debentures in the amount of $2,076,000, representing the full face amount of all Class A Debentures that it is aware are currently outstanding.

7. Subsequently, TCBNA filed an amended claim with respect to the Class B Debentures in the amount of $2,236,000, representing the full face amount of all Class B Debentures that it is aware are currently outstanding.

8. The Class A Debentures and Class B Debentures were issued in exchange for certain 8-1/2% Debentures, as more fully described

below.

9. On or about December 1, 1980, Finance, a Netherlands Antilles corporation and a subsidiary of Pengo, issued $22,500,000 of 8-1/2% Convertible Subordinated guaranteed Debentures due 1995 ("8-1/2% Debentures") through Chemical Bank, as indenture trustee.

10. If an 8-1/2% Debenture was converted into its equivalent number of shares of Pengo common stock based upon the $32.25 conversion price, each Debenture would equate to 31 shares of Pengo common stock. In the third quarter of 1984, when the First Exchange Offer referred to below was implemented,Pengo's common stock was selling at a high of $1.75 and a low of 11/16. If an 8-1/2% Debenture was converted to stock at that time, the 31 shares of Pengo common stock would have been worth a maximum of $54.25 at the high price and a minimum of $21.31 at the low price.

11. The 8-1/2% Debentures were sold to the

public by Finance for the full face amount of $1,000 each.

12. Because of continued financial difficulties, neither Finance nor Pengo as guarantor was able to make the interest payments due with respect to the 8-1/2% Debentures on December 1, 1983, 1984, 1985, 1986 and 1987. Pengo, however, on December 1 of each of the above listed years, accrued interest expense of $85.00 per $1,000 face amount of the 8-1/2% Debentures still outstanding. After the exchange in 1984, $9,295,000 in principal amount of 8-1/2% Debentures were still outstanding. This resulted in an annual interest accrual by Pengo of $790,075. Pengo did not accrue any interest expense relating to the $13,205,000 in principal amount of the Class A and Class B Debentures then issued and outstanding.

13. The 8-1/2% Debentures were suspended from trading on the Luxembourg Stock Exchange on December 12,1983. When trading was suspended,

the 8-1/2% Debentures were priced at approximately 29% of their principal amount, or $290.00 per $1,000 Debenture.

14. On or about June 20, 1984, Finance offered to exchange each 8-1/2% Debenture of a non-interest bearing Class A Debenture in the principal amount of $500.00 and a non-interest bearing Class B Debenture in the principal amount of $500.00, pursuant to an Offering Circular dated June 20, 1984 ("First Exchange Offer").

15. The 8-1/2% Debentures mature in 1995 and the maturity date for both Class A and Class B Debentures was 1991.

16. The 8-1/2% Debentures were subordinated to payment in full of the Class A and Class B Debentures.

17. The Class A Debentures were convertible into Pengo common stock at a price per share equal to the greater of $1.25 or 105% of the closing sale price of the stock on the exchange

date. If a $500 Class A Debenture was converted into Pengo common stock on the exchange date, which was during the third quarter of 1984, such stock would have had a value based upon high of $1.75 and low of 11/16 as follows:

High Conversion Price of Class A ($1.75) ($1.05) = $1.84
Low Conversion Price for Class A = $ 1.25

High Value (($500) ($1.75))/($1.84) = $475.54
Low Value (($500) ($0.69))/(1.25) = $276.00

18. The Class B Debentures were convertible into Pengo common stock at a price per share equal to $4.50. If a $500 Class B Debenture was converted into Pengo common stock on the exchange date, which was during the third quarter of 1984, such stock would have had a market value based upon the high of $1.75 and a low of 11/165 (sic) as follows:

High Value (($500) ($1.75))/($4.50)= $194.44
Low Value (($500) ($0.69))/($4.50)= $ 76.66

19. The equivalent stock value of a $1,000 8-1/2% Debenture at the time of the First Exchange Offer was:

High Value = $54.25
Low Value = $21.31

The equivalent common stock value of an 8-1/2% Debenture at the time of the First Exchange Offer was converted into $500 principal amount of Class A Debentures and $500 principal amount of Class B Debentures was:

High Value ($475.54 + $194.44) = $669.98
Low Value ($276.00 + $ 76.66) = $352.66

20. The First Exchange Offer was required by a certain standstill agreement between Pengo and its senior secured lenders as part of an out-of-court workout to enable Pengo to restructure its various indebtedness. The First Exchange Offer expired on July 12, 1984, and tender offers were irrevocable until August 15, 1984.

21. Following this First Exchange Offer, some $13,205,000 of the 8-1/2% Debentures (58.7% of the issue) were tendered and accepted. Finance and Pengo, as guarantor, remained in default on the 8-1/2% Debentures that were not tendered because of their failure to make

interest payments on the 8-1/2% Debentures from and after December 1, 1983. Finance and Pengo never accrued any interest expenses with respect to the Class A Debentures and Class B Debentures.

22. The Class A Debentures and Class B Debentures were not traded on the date of issuance or thereafter. A significant number of the class A Debentures and Class B Debentures were converted to Pengo common stock.

23. The 8-1/2% Debentures traded at approximately 34%, or $340.00 per each $1,000 debenture, shortly before the Offering Circular was issued on the over-the -counter market in the United States.

24. The holders of 8-1/2% Debentures who tendered their debentures for exchange waived the interest payment due on December 1, 1983.

Having considered the stipulated facts and the arguments of counsel, the bankruptcy court concluded that the objections of Licht and the

Committee should be sustained and the claims filed by TCBNA should be reduced to eliminated unmatured interest.

Issues on Appeal

TCBNA presents one issue on appeal, to wit: whether the bankruptcy court erred as a matter of law by determining that the Class A and Class B debenture claims included additional interest, which could not be allowed.

Standard of Review

The underlying case was tried on stipulated facts. Accordingly, the bankruptcy court issued its ruling as a matter of law. The bankruptcy court's order is therefore subject to de novo review. Pierson & Gaylen v. Creel & Atwood)in re Consolidated Banchares, Inc.), 785 F.2d 1249, 1252 (5th Cir. 1986).

Discussion of Authorities

The issue in this case is whether a discount was created as a result of the exchange of 8.5% debentures for Class A and Class B debentures.

If a discount was created, then TCBNA's claims for the full face value of the Class A and Class B debentures included unmatured interest, which is not allowable under 11 U.S.C. 502(b)(2) as part of a claim.

In support of its position that no discount was created, TCBNA relies on Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134 (1974). In that case, a corporation exchanged its preferred stock, which had originally been sold for $50.00 per share, for debentures with a face value of $50.00 each. At the time of the exchange, the fair market value of the preferred stock was less than its original sales price. The issue before the court was whether the corporation was entitled to an income tax deduction for amortizable debt discount claimed to be the difference between the face amount of the debentures and the preferred's value at the time of the exchange. National Alfalfa, 417 U.S. at 136. The Supreme

Court held that when a corporation issues obligations in exchange for its outstanding preferred, no discount arises if the amount that was received upon issuance of the preferred is equal to the face amount of the obligations issued for exchange. The basis for the court's holding was that from the corporation's perspective it had merely replaced that portion of its paid-in capital represented by its preferred with paid-in capital represented by its debentures, ie., the corporation did not incur any additional cost for the use of its principal and the corporation's assets were neither increased nor diminished. Id. at 151-52.

In this case, appellee Licht recognizes that no additional cost was incurred by the corporation as a result of the exchange and that Pengo actually benefitted therefrom. Any 8.5% debenture holder who elected to accept the exchange offer "caused Pengo Not to have to pay $85.00 per year in interest to 1995." Licht

brief at 18. Moreover, "the savings to Pengo due to the exchange was significant" and, as a result of the exchange, Pengo's yearly interest expense was reduced from $1,912,500.00 to $790,075.00, which equates to a savings of $8,715,300.00 over the life of the 8.5% debentures. Id. at 21-22.

Subsequent cases that have discussed National Alfalfa included Texstar Corp. v. United States, 688 F.2d 362 (5th Cir. 1982); Gulf, Mobile & Ohio Railroad Co. v. United States, 579 F.2d 892(5th Cir. 1978); and Cities Service Co. V. United States, 522 F.2d 1281 (2nd Cir. 1974), cert. denied, 423 U.S. 827 (1975). Each case distinguished National Alfalfa as a case where the original value received for each preferred share was equal to the face amount of the debentures exchanged. Texstar, 688 F.2d at 1287. The Gulf, Mobile case made the further distinction that the exchange in National Alfalfa was not a voluntary exchange affected by

market forces. In discussing this distinction, the court recognized that:

> some exchanges involving preferred shareholders are only euphemistically styled as "voluntary." If, for instance, preferred stock has accumulated large arrears of undeclared and unpaid dividends, it is not uncommon for corporations to offer to exchange the old preferred for new preferred shares that have no arrears but have a claim to future dividends prior to that of the old preferred. If future earnings are expected to be sufficient to pay only dividends on the prior preferred, the old preferred will be forced to convert or else receive nothing.

579 F.2d at 899 n. 19. The facts of this case fit the "voluntary" exchange scenario described by the Fifth Circuit. In this case, like National Alfalfa, the primary purpose of the exchange was to eliminated arrearage, not to save on taxes. Contra Gulf, Mobile, 579 F.2d at 899 n. 19.

Appellees seek to distinguish this case from National Alfalfa, the primary purpose of the exchange was to eliminate arrearage, not to save taxes, They rely primarily on two recent bankruptcy court decisions in support of their

position. The first case is In re Chateaugay Corporation , 109 Bankr. 51 (Bankr. S.D.N.Y.1990); the second is In re Alleghwny International, Inc., 100 Bankr. 247 (Bankr. W.D. Pa. 1989). Neither case is apropos because both deal with situations where the face amount of the new debentures exceeded the original consideration paid for the preferred stock exchange. The Allegheny case specifically recognized that where the original consideration equals the face amount of the debentures, no discount can arise since the issue price equals their face amount. 100 Bankr. at 252. The Chateaugay case is further distinguishable because there the court took into account the language contained in an offering circular in determining that the exchange resulted in original issue discount. Chateaugay, 109 Bankr. at 56. The offering circular in this case was not admitted as any evidence on appeal. Hill v. Trustee of Indiana University, 537 F.2d 248, 251

n.2 (7th Cir. 1976); Tanner v. United states , 401 F.2d 281, 288 (8th Cir. 1968), cert. denied, 393 U.S. 1109 (1969). The statement contained in such offering circular would not be dispositive in any event.

Based on the facts as stipulated by the parties, the court concludes that the claim submitted by TCBNA did not include any claim for original issue discount. The bankruptcy court erred as a matter of law in concluding otherwise. Accordingly,

The court ORDERS that the bankruptcy court's order sustaining objections to TCBNA's claim be and is hereby reversed.

SIGNED July 3, 1991

_____

JOHN McBryde
United states District Judge

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

IN RE	)	
	)	
PENGO INDUSTRIES, INC.	)	
AND PENGO FINANCE, N.V.	)	
	)	
Debtor	)	
	)	
	)	
TEXAS COMMERCE BANK	)	
NATIONAL ASSOCIATION	)	
	)	CIVIL ACTION
Appellant	)	NO. CA-90-238-A
	)	
VS	)	
DR SEYMOUR LICHT AND THE	)	
OFFICIAL UNSECURED	)	
CREDITORS COMMITTEE	)	
	)	
Appellee	)	
	)	

J U D G M E N T

In accordance with this court's memorandum opinion and order of even date herewithin,

The court ORDERS, ADJUDGES and DECREES that the bankruptcy court's order signed December 28, 1989, sustaining objections to claim of Texas Commerce Bank National Association as indenture trustee for Class A and Class B debentures be

and is hereby reversed.

SIGNED July 3, 1991

JOHN McBRYDE
United States District Judge

APPENDIX C

Edgar H. Booth, Esq.
Warshaw Burstein Cohn
Schlesinger & Kuh
555 Fifth Avenue
New York, New York 10017
(212) 984-7700

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

In re	) No. 488-41303-MT-11
	) (Chapter 11)
PENGO INDUSTRIES INC)	
Pengo Finance, N.V.)	
)	
Debtor)	
)	

ORDER SUSTAINING OBJECTIONS TO CLAIM OF TEXAS COMMERCE BANK NATIONAL ASSOCIATION AS INDENTURE TRUSTEE FOR CLASS A AND CLASS B DEBENTURES

On the 18th day of December 1989 came on to be heard the objections ("objections") filed by Dr. Seymour Licht ("Licht") and the Official Committee of Unsecured Creditors ("Committee") of Pengo Industries, Inc ("Pengo" or "Debtor") to the claims filed by Texas Commerce bank National Association, as Indenture Trustee ("TCNBNA") on behalf of the holders of certain

Class A Debentures and Class B Debentures, as amended by TCBNA after the objection was filed.

Licht, the Committee and TCBNA have filed a "Stipulation of Facts Re Objection to Claim of Texas Commerce Bank National Association as Indenture trustee for Class A and Class B Debentures," dated and executed variously in December 1989; and the Court, having considered the Objections and the claims and amended claims filed by TCBNA, and having heard counsel for the parties and Licht pro se on December 15, 1989, and good cause having been shown in support of the Objections, finds as follows:

1. TCBNA is the Indenture Trustee with respect to the Class A Non-Interest Bearing Convertible Senior Subordinated Guaranteed Debentures due in 1991 ("Class A Debentures") and Class B Non-Interest Bearing Convertible Senior Subordinated Debentures due in 1991 ("Class B Debentures"), both issued by Pengo Finance, N.V. ("Finance") and guaranteed by

Pengo.

2. TCBNA filed a proof of claim with respect to the Class A Debentures in the amount of $4,552,000, representing the full face amount of the Class A Debentures allegedly outstanding as of the date of the filing of Pengo's involuntary bankruptcy petition ("Petition Date").

3. TCBNA filed a proof of claim with respect to the Class B Debentures in the amount of $5,439,500, representing the full face amount of the Class B Debentures allegedly outstanding as of the Petition Date.

4. Licht, a holder of 8-1/2% Debentures, duly objected to the two claims filed by TCBNA for the full face amount of the Class A Debentures and Class B Debentures.

5. The Committee duly objected to the two claims filed by TCBNA for the full face amount of the Class A Debentures and Class B Debentures.

6. Subsequently, TCBNA filed an amended

claim with respect to the Class A Debentures in the amount of $2,076,000, representing the full face amount of all Class A Debentures that it is aware are currently outstanding.

7. Subsequently, TCBNA filed an amended claim with respect to the Class B Debentures in the amount of $2,236,000, representing the full face amount of all Class B Debentures that it is aware are currently outstanding.

8. The Class A Debentures and Class B Debentures were issued in exchange for certain 8-1/2% Debentures, as more fully described below.

9. On or about December 1, 1980, Finance, a Netherlands Antilles corporation and a subsidiary of Pengo, issued $22,500,000 of 8-1/2% Convertible Subordinated guaranteed Debentures due 1995 ("8-1/2% Debentures") through Chemical Bank, as indenture trustee.

10. If an 8-1/2% Debenture was converted into its equivalent number of shares of Pengo

common stock based upon the $32.25 conversion price, each Debenture would equate to 31 shares of Pengo common stock. In the third quarter of 1984, when the First Exchange Offer referred to below was implemented,Pengo's common stock was selling at a high of $1.75 and a low of 11/16. If an 8-1/2% Debenture was converted to stock at that time, the 31 shares of Pengo common stock would have been worth a maximum of $54.25 at the high price and a minimum of $21.31 at the low price.

11. The 8-1/2% Debentures were sold to the public by Finance for the full face amount of $1,000 each.

12. Because of continued financial difficulties, neither Finance nor Pengo as guarantor was able to make the interest payments due with respect to the 8-1/2% Debentures on December 1, 1983, 1984, 1985, 1986 and 1987. Pengo, however, on December 1 of each of the above listed years, accrued interest expense of

$85.00 per $1,000 face amount of the 8-1/2% Debentures still outstanding. After the exchange in 1984, $9,295,000 in principal amount of 8-1/2% Debentures were still outstanding. This resulted in an annual interest accrual by Pengo of $790,075. Pengo did not accrue any interest expense relating to the $13,205,000 in principal amount of the Class A and Class B Debentures then issued and outstanding.

13. The 8-1/2% Debentures were suspended from trading on the Luxembourg Stock Exchange on December 12,1983. When trading was suspended, the 8-1/2% Debentures were priced at approximately 29% of their principal amount, or $290.00 per $1,000 Debenture.

14. On or about June 20, 1984, Finance offered to exchange each 8-1/2% Debenture of a non-interest bearing Class A Debenture in the principal amount of $500.00 and a non-interest bearing Class B Debenture in the principal amount of $500.00, pursuant to an Offering

Circular dated June 20, 1984 ("First Exchange Offer").

15. The 8-1/2% Debentures mature in 1995 and the maturity date for both Class A and Class B Debentures was 1991.

16. The 8-1/2% Debentures were subordinated to payment in full of the Class A and Class B Debentures.

17. The Class A Debentures were convertible into Pengo common stock at a price per share equal to the greater of $1.25 or 105% of the closing sale price of the stock on the exchange date. If a $500 Class A Debenture was converted into Pengo common stock on the exchange date, which was during the third quarter of 1984, such stock would have had a value based upon high of $1.75 and low of 11/16 as follows:

High Conversion Price of Class A ($1.75) ($1.05) = $1.84
Low Conversion Price for Class A = $1.25

High Value (($500) ($1.75))/($1.84) = $475.54
Low Value (($500) ($0.69))/(1.25) = $276.00

18. The Class B Debentures were convertible

into Pengo common stock at a price per share equal to $4.50. If a $500 Class B Debenture was converted into Pengo common stock on the exchange date, which was during the third quarter of 1984, such stock would have had a market value based upon the high of $1.75 and a low of 11/165 (sic) as follows:

High Value (($500) ($1.75))/($4.50) = $194.44
Low Value ($500) ($0.69))/($4.50) = $ 76.66

19. The equivalent stock value of a $1,000 8-1/2% Debenture at the time of the First Exchange Offer was:

High Value = $54.25
Low Value = $21.31

The equivalent common stock value of an 8-1/2% Debenture at the time of the First Exchange Offer was converted into $500 principal amount of Class A Debentures and $500 principal amount of Class B Debentures was:

High Value ($475.54 + $194.44) = $669.98
Low Value ($276.00 + $ 76.66) = $352.66

20. The First Exchange Offer was required by a certain standstill agreement between Pengo and

its senior secured lenders as part of an out-of-court workout to enable Pengo to restructure its various indebtedness. The First Exchange Offer expired on July 12, 1984, and tender offers were irrevocable until August 15, 1984.

21. Following this First Exchange Offer, some $13,205,000 of the 8-1/2% Debentures (58.7% of the issue) were tendered and accepted. Finance and Pengo, as guarantor, remained in default on the 8-1/2% Debentures that were not tendered because of their failure to make interest payments on the 8-1/2% Debentures from and after December 1, 1983. Finance and Pengo never accrued any interest expenses with respect to the Class A Debentures and Class B Debentures.

22. The Class A Debentures and Class B Debentures were not traded on the date of issuance or thereafter. A significant number of the class A Debentures and Class B Debentures were converted to Pengo common stock.

23. The 8-1/2% Debentures traded at approximately 34%, or $340.00 per each $1,000 debenture, shortly before the Offering Circular was issued on the over-the -counter market in the United States.

24. The holders of 8-1/2% Debentures who tendered their debentures for exchange waived the interest payment due on December 1, 1983.

Having considered the stipulated facts and the arguments of counsel, the bankruptcy court concluded that the objections of Licht and the Committee should be sustained and the claims filed by TCBNA should be reduced to eliminated unmatured interest.

Signed this 28th day of december 1989.

(Massie Tillman)

United States Bankruptcy Judge

APPENDIX D

STIPULATED FACTS IN BANKRUPTCY PROCEEDING

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(713) 961-9045

ATTORNEY FOR TEXAS COMMERCE BANK
NATIONAL ASSOCIATION

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

IN RE	)	
	)	
PENGO INDUSTRIES, INC.	)CASE NO.	488-41303-MT11
PENGO FINANCE, N.V.	)	(CHAPTER 11)
	)	
DEBTORS	)	

STIPULATION OF FACTS RE OBJECTION TO CLAIM OF TEXAS COMMERCE BANK NATIONAL ASSOCIATION AS INDENTURE TRUSTEE FOR CLASS A AND B DEBENTURES

DR SEYMOUR LICHT ("Licht") and the OFFICIAL COMMITTEE OF UNSECURED CREDITORS (Committee") of PENGO INDUSTRIES, INC. ("Pengo") have objected to the claims filled by TEXAS COMMERCE BANK NATIONAL ASSOCIATION, INDENTURE TRUSTEE ("TCBNA") on behalf of the holders of Class A

and Class B debentures ("Objections"). The parties hereby stipulate to the following facts with respect to the Objections:

1. TCBNA is the Indenture Trustee with respect to the Class A Non-Interest Bearing Convertible Senior Subordinated Guaranteed Debentures due in 1991 ("Class A Debentures") and Class B Non-Interest Bearing Convertible Senior Subordinated Debentures due in 1991 ("Class B Debentures"), both issued by Pengo Finance, N.V. ("Finance") and guaranteed by Pengo.

2. TCBNA filed a proof of claim with respect to the Class A Debentures in the amount of $4,552,000, representing the full face amount of the Class A Debentures allegedly outstanding as of the date of the filing of Pengo's involuntary bankruptcy petition ("Petition Date").

3. TCBNA filed a proof of claim with respect to the Class B Debentures in the amount of $5,439,500, representing the full face amount of

the Class B Debentures allegedly outstanding as of the Petition Date.

4. Licht, a holder of 8-1/2% Debentures, duly objected to the two claims filed by TCBNA for the full face amount of the Class A Debentures and Class B Debentures.

5. The Committee duly objected to the two claims filed by TCBNA for the full face amount of the Class A Debentures and Class B Debentures.

6. Subsequently, TCBNA filed an amended claim with respect to the Class A Debentures in the amount of $2,076,000, representing the full face amount of all Class A Debentures that it is aware are currently outstanding.

7. Subsequently, TCBNA filed an amended claim with respect to the Class B Debentures in the amount of $2,236,000, representing the full face amount of all Class B Debentures that it is aware are currently outstanding.

8. The Class A Debentures and Class B

Debentures were issued in exchange for certain 8-1/2% Debentures, as more fully described below.

9. On or about December 1, 1980, Finance, a Netherlands Antilles corporation and a subsidiary of Pengo, issued $22,500,000 of 8-1/2% Convertible Subordinated guaranteed Debentures due 1995 ("8-1/2% Debentures") through Chemical Bank, as indenture trustee.

10. If an 8-1/2% Debenture was converted into its equivalent number of shares of Pengo common stock based upon the $32.25 conversion price, each Debenture would equate to 31 shares of Pengo common stock. In the third quarter of 1984, when the First Exchange Offer referred to below was implemented,Pengo's common stock was selling at a high of $1.75 and a low of 11/16. If an 8-1/2% Debenture was converted to stock at that time, the 31 shares of Pengo common stock would have been worth a maximum of $54.25 at the high price and a minimum of $21.31 at the low

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12. Because of continued financial difficulties, neither Finance nor Pengo as guarantor was able to make the interest payments due with respect to the 8-1/2% Debentures on December 1, 1983, 1984, 1985, 1986 and 1987. Pengo, however, on December 1 of each of the above listed years, accrued interest expense of $85.00 per $1,000 face amount of the 8-1/2% Debentures still outstanding. After the exchange in 1984, $9,295,000 in principal amount of 8-1/2% Debentures were still outstanding. This resulted in an annual interest accrual by Pengo of $790,075. Pengo did not accrue any interest expense relating to the $13,205,000 in principal amount of the Class A and Class B Debentures then issued and outstanding.

13. The 8-1/2% Debentures were suspended

from trading on the Luxembourg Stock Exchange on December 12,1983. When trading was suspended, the 8-1/2% Debentures were priced at approximately 29% of their principal amount, or $290.00 per $1,000 Debenture.

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15. The 8-1/2% Debentures mature in 1995 and the maturity date for both Class A and Class B Debentures was 1991.

16. The 8-1/2% Debentures were subordinated to payment in full of the Class A and Class B Debentures.

17. The Class A Debentures were convertible into Pengo common stock at a price per share

equal to the greater of $1.25 or 105% of the closing sale price of the stock on the exchange date. If a $500 Class A Debenture was converted into Pengo common stock on the exchange date, which was during the third quarter of 1984, such stock would have had a value based upon high of $1.75 and low of 11/16 as follows:

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Low Conversion Price for Class A = $1.25

High Value (($500) ($1.75))/($1.84) = $475.54
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18. The Class B Debentures were convertible into Pengo common stock at a price per share equal to $4.50. If a $500 Class B Debenture was converted into Pengo common stock on the exchange date, which was during the third quarter of 1984, such stock would have had a market value based upon the high of $1.75 and a low of 11/165 (sic) as follows:

High Value (($500) ($1.75))/($4.50) = $194.44
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19. The equivalent stock value of a $1,000

8-1/2% Debenture at the time of the First Exchange Offer was:

High Value = $54.25
Low Value = $21.31

The equivalent common stock value of an 8-1/2% Debenture at the time of the First Exchange Offer was converted into $500 principal amount of Class A Debentures and $500 principal amount of Class B Debentures was:

High Value ($475.54 + $194.44) = $669.98
Low Value ($276.00 + $ 76.66) = $352.66

20. The First Exchange Offer was required by a certain standstill agreement between Pengo and its senior secured lenders as part of an out-of-court workout to enable Pengo to restructure its various indebtedness. The First Exchange Offer expired on July 12, 1984, and tender offers were irrevocable until August 15, 1984.

21. Following this First Exchange Offer, some $13,205,000 of the 8-1/2% Debentures (58.7% of the issue) were tendered and accepted. Finance and Pengo, as guarantor, remained in

default on the 8-1/2% Debentures that were not tendered because of their failure to make interest payments on the 8-1/2% Debentures from and after December 1, 1983. Finance and Pengo never accrued any interest expenses with respect to the Class A Debentures and Class B Debentures.

22. The Class A Debentures and Class B Debentures were not traded on the date of issuance or thereafter. A significant number of the class A Debentures and Class B Debentures were converted to Pengo common stock.

23. The 8-1/2% Debentures traded at approximately 34%, or $340.00 per each $1,000 debenture, shortly before the Offering Circular was issued on the over-the -counter market in the United States.

24. The holders of 8-1/2% Debentures who tendered their debentures for exchange waived the interest payment due on December 1, 1983.

Having considered the stipulated facts and

the arguments of counsel, the bankruptcy court concluded that the objections of Licht and the Committee should be sustained and the claims filed by TCBNA should be reduced to eliminated unmatured interest.

Respectfully submitted

Dated: Houston, Texas

WEYCER, KAPLAN, PULASKI & ZUBER

By:
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APPENDIX E

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON

WASHINGTON PUBLIC POWER SUPPLY SYSTEM SECURITIES LITIGATION	)	MDL No. 551 (All Cases)
	)	ORDER

Certain defendants [1] have moved to dismiss tort and securities claims brought by Chemical Bank on behalf of bondholders or in the alternative to dismiss the claims of certain class plaintiffs. The motion stems from Chemical Bank's contention that bond purchasers receive an assignment of tort claims held by predecessor bondholders when WPPSS Project 4/5 bonds are sold.[2]

---

[1] Washington Public Power Supply System; Director Defendants; Members Non-Participants, Benton Rural Electric Association; and certain oregon defendants.

[2] Defendants contend that the plaintiffs' claims are conflicting and mutually exclusive. However, Chemical Bank seems to take the position that any tort recovery for post petition termination purchasers would not diminish any tort recovery of class plaintiffs.

Chemical Bank, representing current bondholders, and Class Plaintiffs, representing purchasers of WPPSS 4/5 bonds prior to June 15, 1983,[3] both seek to assert tort and securities claims stemming from alleged omissions or misrepresentations. Chemical Bank contends that whenever bonds are sold, successor bondholders receive, as a matter of law[4], an assignment of such tort claims as were held by their predecessor. Class plaintiffs submit that such claims remain with original purchasers even if bonds are subsequently resold.

Federal Securities Claims

This issue need not be resolved to dispose of this motion.

[3] This was the date of the Washington Supreme Court decision that relieved the Washington Participants of contractual liability of the Participants' Agreement. *See Chemical Bank v. Washington Public Power Supply System*, 99 Wn2d 772, 666 P.2d 329 (1983), Cert. denied, 471 U.S. 1065 (1985).

[4] This motion does not involve the issue of express assignment of such rights.

The issue of whether subsequent purchasers automatically acquire causes of action for violation of federal securities laws and related state law claims was considered by the Ninth Circuit in *re Nucorp Energy Securities Litigation,* 772 F.2d 1486 (9th Cir. 1986). The opinion of the Ninth Circuit in that action is determinative of the federal claims here.

Nucorp involved claims of subsequent purchasers of convertible debentures. Class members in the underlying litigation had purchased Nucorp Energy, Inc. convertible debentures prior to the company's public announcement of financial difficulties. *Nucorp* plaintiffs had purchased debentures from class members after the public disclosure. They argued that they had automatically acquired their sellers' federal and state causes of action.

The Ninth Circuit affirmed dismissal on the merits of plaintiffs' claim that class members' federal causes of action had been automatically

assigned them upon purchase of the securities. As the Nucorp court observed, [a] cause of action arising from reliance on misrepresentation is personal to those persons who relied; it does not follow the security to remote purchasers who had no basis for reliance. *Id.* at 1490 (quoting *Independent Investor Protective League v. Saunders*, 64 F.R.D. 564, 572 (E.D. Pa. 1974)).

Likewise in the instant action, purchasers of bonds after June 15, 1983 did not automatically obtain their predecessors' federal causes of action, it any. Such rights belong to persons who have been harmed by the misconduct of others. They do not accompany securities as they move from holders to holder, but remain with the ones who claim injury. *See Nucorp*, 7725 F.2d 1486; *See also Rose v. Arkansas Valley Environmental & Utility Authority*, 562 F. Supp. 1180(W.D. mo 1983) (cause of action personal to predecessor purchaser where plaintiff in 10(b)

and 10b-5 action was donee or legatee); Independent Investor Protective League v. Saunders, 64 F.R.D. 564 (E.D. Pa. 1974)(mere purchase of bond without express agreement insufficient to assert rights of previous bondholders).

Accordingly, federal claims of bondholders who assert claims based solely upon a theory of automatic assignment are dismissed. Class plaintiffs retain the right to assert federal claims whether or not they disposed of the bonds.

State Law Claims

Chemical Bank asserts that current bondholders posses securities and tort claims under state law. in addition to federal securities claims, as a result of automatic assignment upon resale of the 4/5 bonds. Because Chemical Bank alleges diversity jurisdiction as to these state law claims, the Court must address them on the merits. According to choice

of law rules Washington law applies. See Order of January 24, 1986 at 29-34.

Washington courts have not spoken on the precise question of automatic assignment. However, the Washington Supreme Court observed long ago that an action for damages for fraudulent representations can be brought only by the person to whom the representations were made. *Heian v. Fisher*, 189 Wash. 59,63,63P.2d 518,519(1937). The same court has also said that the right to damages for injury to real property is a personal one. It belongs to the owner of property and will not pass to another unless it is expressly conveyed, even through the property itself may be deeded away. *Gilliam v. City of Centralia*, 14 Wn.2d 523,128P.2d 661(1942). The Court is persuaded that these principles apply in the instant action. Further, because the language of the Washington State Securities Act, RCW 21.20-010 et seq., closely parallels that of Rule 10b-5 of the 1934

Securities Exchange Act and section 17 (a) of the 1933 Securities Act, it follows that the question of automatic assignment would be treated similarly.

Therefore, this Court concludes that Washington law would not recognize automatic assignment or transfer of a right to seek a remedy for fraudulent representation under either the common law or the state's securities laws in connection with the purchase of securities State tort and securities claims of bondholders based solely on a theory of automatic assignment are accordingly dismissed.

Dated December 22, 1987

William D. Browning
U.S. District Judge

APPENDIX F

THE FOLLOWING SUPREME COURT RULES ARE APPLICABLE TO THIS PETITION

RULE 10(1)(C)

1. A review on a writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only when there are special and important reasons therefor. The following, while neither controlling nor fully measuring the Court's discretion, indicate the character of reasons that it will be considered:

> (c) When a state court or a United States court of appeals has decided an important question of federal law which has not been, but should be, settled by this Court, or has decided a federal question in a way that conflicts with applicable decisions of this Court.

RULE 13.4

.4 The time for filing a petition for a writ of certiorari runs from the date the judgment or decree sought to be reviewed is rendered, and not from the date of the issuance of the mandate (or its equivalent under local law). **However, if a petition for rehearing is timely filed in the lower court by any party in the case, the time for filing the petition for a writ of certiorari for all parties (whether or not they requested rehearing or joined in the petition for rehearing) runs from the date of the denial of the petition for rehearing or the entry of a subsequent judgment....**

Supreme Court, U.S.
FILED
NOV 3 1992
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(2)

No. 92-596

In The

Supreme Court of the United States

October Term, 1992

DR. SEYMOUR LICHT P.E.,

Petitioner,

v.

TEXAS COMMERCE BANK, N.A.,

Respondent.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Does a debt for debt face value exchange in a consensual out of court restructuring create unmatured interest, in the form of original issue discount, within the meaning of the Bankruptcy Code provision which disallows claims for unmatured interest?

LIST OF PARTIES

The undersigned counsel of record certifies that the following listed persons were parties to the proceeding in the court whose judgment is sought to be reviewed.

1. Class 5 Unsecured Creditors under Debtor's First Amended Plan of Reorganization.

2. Dr. Seymour Licht, Petitioner.

3. Richard H. Kuh and Warshaw, Burstein, Cohen, Schlesinger & Kuh, 555 Fifth Avenue, New York, New York 10017, attorneys for the Official Committee of Unsecured Creditors of Pengo Industries, Inc.

4. Holders of Class A and Class B Subordinated Guaranteed Debentures due December 1, 1991, of Pengo Industries, Inc.

5. Texas Commerce Bank, National Association, as Indenture Trustee, Respondent.

6. Edward L. Rothberg and Weycer, Kaplan, Pulaski & Zuber, P.C., 1400 Summit Tower, Eleven Greenway Plaza, Houston, Texas 77046, attorney for Respondent, Texas Commerce Bank, National Association.

Texas Commerce Bank, National Association's parent corporation is Texas Commerce Bancshares which is wholly owned by Chemical Banking Corporation. Texas Commerce Bank, National Association has no nonwholly owned subsidiaries.

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STATUTES

11 U.S.C. Section 502(b)(2) 1

STATEMENT OF THE CASE

I. Procedural History

Dr. Seymour Licht's ("Licht") Petition for Writ of Certiorari in this matter arises from a bankruptcy case in which Licht is a holder of certain 8.5% debentures issued by the Chapter 11 Debtors, Pengo Finance, N.V. and Pengo Industries, Inc. ("Pengo"). Texas Commerce Bank, National Association ("TCBNA"), is the Indenture Trustee on behalf of the Holders of Class A and Class B debentures issued and guaranteed by Pengo. The full face amount of outstanding Class A and Class B debentures is $2,042,000 and $2,085,500 respectively.

TCBNA originally filed proofs of claim on behalf of the Class A and Class B Debenture Holders in Pengo's bankruptcy case representing 19,983 separate debentures with a face value of $500 each. (R. 63).[1] On October 2, 1989, Licht filed objections to the claims of the Class A and Class B Debenture Holders claiming that such debentures were sold at a discount which created unmatured interest which was not allowable under 11 U.S.C. Section 502(b)(2). (R. 1-16). The Official Committee of Unsecured Creditors ("Committee") joined in Licht's objection. (R. 31-47). After the parties stipulated to all of the essential facts, the Bankruptcy Court conducted an oral hearing and on December 28, 1989, sustained the objection of Licht and the Committee. (R. 420-27). The effect of this ruling was to reduce the claims of the Class A and Class B

---

[1] References to the Record on Appeal will appear as (R. ___).

Debenture Holders to $1,411,812.35 and $1,522,626.40, respectively.[2] (R. 47).

On January 8, 1990, TCBNA timely filed a notice of appeal of the Bankruptcy Court's order to the District Court. (R. page unnumbered). All parties filed their appellate briefs, and on July 3, 1991, the District Court reversed the Bankruptcy Court's decision and reinstated the full face amount of the Class A and Class B Debenture Holder claims. (R. 529). On or about July 23, 1991, Licht timely filed a notice of appeal to the United States Court of Appeals for the Fifth Circuit. (R. 530).

On June 12, 1992, the United States Court of Appeals for the Fifth Circuit issued its opinion affirming the ruling of the District Court. Licht has filed a Petition for Writ of Certiorari seeking a review of the decision of the Fifth Circuit Court of Appeals.

II. Statement of Facts

In 1980, Pengo issued convertible debentures in $1,000 denominations bearing interest at the rate of 8.5% payable annually with principal coming due in 1995 (the "8.5% Debentures"). (See Stipulation of Facts contained in the joint record excerpts at tab 6, paragraph 9). The 8.5% debentures were sold to the public for the full face value

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[2] The amount of the claims was subsequently reduced by TCBNA to reflect representation of only 8,255 separate debentures with a face value of $500 each. Application of the formula used by the Bankruptcy Court in its decision results in setting the claims of Class A and Class B Debenture Holders at $1,388,355.88 and $1,417,931.40, respectively.

of $1,000 each. (*Id.* at paragraph 11). Since Pengo received the full face value for each 8.5% debenture, there was no discount which created additional or unmatured interest.[3]

Due to financial difficulties, Pengo was unable to make the interest payments due with respect to the 8.5% debentures for the years 1983 through 1987. (*Id.* at paragraph 12). Pursuant to an out of court workout consummated in 1984, Pengo offered to exchange each 8.5% debenture for a non-interest bearing Class A debenture in the principal amount of $500 and a non-interest bearing Class B debenture in the principal amount of $500 (*Id.* at paragraphs 14, 20). Thus, the 8.5% Debenture Holders who participated in the exchange received two (2) debentures with a total face value of $1,000 for each of their $1,000 8.5% debentures. (*Id.*). Hence, the Class A and Class B debentures were not issued at a discount.

The Debenture Holders who participated in this exchange waived the payment of past due interest. (*Id.* at paragraph 24). Further, Pengo gained an additional benefit because the new Class A and Class B debentures were non-interest bearing, allowing Pengo to accrue no interest expense with respect to the Class A and Class B debentures. (*Id.* at paragraph 21).

---

[3] If the 8.5% debentures were sold for $900 each, the $100 discount would be considered additional interest over and above the 8.5% stated rate. Such discount interest would have accrued rateably over the life of the debentures.

REASONS FOR DENYING THE WRIT

I. The United States Court Of Appeals For The Fifth Circuit Was Correct In Holding That The Debt For Debt Face Value Exchange Involved In This Case Did Not Create Unmatured Interest In The Form Of Original Issue Discount

The Fifth Circuit Court of Appeals began its review and analysis of this case by noting that Section 502(b) of the Bankruptcy Code requires the Bankruptcy Court to disallow any claim for unmatured interest. *Texas Commerce Bank, N.A. v. Licht (In Re Pengo Industries, Inc.)*, 962 F.2d 543, 546 (5th Cir. 1992), *petition for cert. filed*, (No. 92-596, October Term 1992). The Court then noted that original issue discount ("OID"), which results from the issuance of a debt instrument for an amount less than its face value, does constitute unmatured interest. *Id.* (Citations omitted).

In affirming the District Court's decision, the Fifth Circuit relied on an opinion issued by the Second Circuit Court of Appeals in *LTV Corp. v. Valley Fidelity Bank & Trust Co. (In Re Chateaugay Corp.)*, 961 F.2d 378 (2nd Cir. 1992). In *Chateaugay*, the Second Circuit dealt with a fact situation in which the company exchanged new senior notes with a face value of $1,000 for old debentures with a face value of $1,000. *Id.* at 380. As in *Chateaugay*, the Pengo exchange offer constituted a face value exchange meaning that rather than issuing the Class A and Class B debentures at a discount creating unmatured interest "Pengo simply substituted 'new indebtedness for an existing debenture, modifying terms or conditions but not

reducing the principal amount of the debt.' " *Pengo* at 547. (Citations omitted).

As in *Chateaugay,* the Fifth Circuit Court of Appeals also relied on the importance of encouraging out of court workouts in bankruptcy cases. *Id.* at 549. The court noted that, "a rule that a debt for debt face value exchange in a consensual out of court workout creates OID concomitantly reduces the likelihood that creditors will 'cooperate with a struggling debtor' because such a rule lowers the exchanging creditors claims in bankruptcy." *Id.* The court then notes that such a policy would "surely translate into 'fewer out of court debt exchanges and more Chapter 11 filings.' " *Id.* (Citations omitted).

The court went on to note that it strongly disfavored "a judicial interpretation of the Bankruptcy Code that contravenes the substantial congressional policy favoring out of court consensual workouts." *Id.* Based on its analysis of the OID and unmatured interest issues, the Fifth Circuit Court of Appeals held that "the debt for debt face value exchange in the Pengo consensual workout did not create original issue discount for the purpose of Section 502(b)(2)." *Id.*

The undisputed facts in this case establish that the original consideration paid for the 8.5% debenture equalled the face amount of the Class A and Class B debentures combination exchanged therefore. Because the face value of the exchanged security equalled the original consideration paid for the underlying security, no discount occurred which would create unmatured interest or OID. As noted by the Fifth Circuit Court, an incorrect analysis of this issue results in a direct contravention of

the congressional policy underlying the Bankruptcy Code which favors out of court workouts. As such, the opinion of the Fifth Circuit Court of Appeals is correct and Licht's Petition for Writ of Certiorari should be denied.

II. No Conflict Exists Between The Circuit Courts Of Appeal On This Issue

In its opinion, the Fifth Circuit Court of Appeals noted that only one other Circuit Court of Appeals has addressed the issue of whether a debt for debt face value exchange in a consensual out of court restructuring generated unmatured interest within the meaning of Section 502(b)(2) of the Bankruptcy Code. *Pengo* at 548-49. In *Chateaugay,* the Second Circuit Court of Appeals dealt with the same issue of alleged OID and held that no new OID arose on a debt for debt exchange. *Chateaugay,* at 383. The *Chateaugay* court found that because the original debentures were issued at a discount the original issue discount carried over from the old debt to the new debt, but that no new OID was created by a face value debt for debt exchange. *Id.*

In its decision and opinion in this case, the Fifth Circuit Court of Appeals relied heavily on the reasoning of the Second Circuit's *Chateaugay* opinion. In fact, the Fifth Circuit specifically endorsed the reasoning of the Second Circuit in attempting to align the resolution of the OID issue with the favored policy of encouraging out of court workouts. *Pengo* at 549.

The Fifth Circuit Court of Appeals and the Second Circuit Court of Appeals are the only Circuit Courts of Appeal which have addressed the issue of whether a debt

for debt face value exchange in a consensual out of court restructuring creates unmatured interest in the form of original issue discount within the meaning of the Bankruptcy Code provision disallowing claims for unmatured interest. In both cases, the courts have found that such an exchange does not create unmatured interest which would be disallowed under the Bankruptcy Code.

It is important to note that in *Pengo*, the Fifth Circuit described a number of scenarios which it specifically refused to address by its decision in this case. *Pengo* at 549-51. First, the court refused to consider when an original issue of debt might create a discount and instead confined its decision to situations involving the exchange of debt instruments in a consensual out of court restructuring. *Id.* at 549-50. Likewise, the court refused to address a situation where holders exchange a debt instrument for a new debt instrument with a lower face amount. *Id.* at 550. The court refused to consider debt for equity exchanges as opposed to debt for debt exchanges. *Id.* In this area, the court specifically distinguished the case of *In Re Allegheny Int'l, Inc.*, 100 B.R. 247 (Bkrtcy. W.D. PA. 1989), because that case dealt with a debt for equity swap and not a debt for debt exchange. *Id.* Finally, the *Pengo* court drew a distinction between a debt for debt exchange in a bankruptcy case and the treatment of a debt for debt exchange under the Tax Code. *Id.* The court noted the differing policies underlying the Bankruptcy Code and Tax Code and, quoting the Second Circuit, stated that "the reasoning underlying the tax treatment of debt for debt exchanges simply does not apply in the bankruptcy context." *Id.* (Citations omitted).

In his Petition for Writ of Certiorari, Licht alleges that the Fifth Circuit's opinion in this case conflicts with a number of other opinions from both the United States Supreme Court and various Circuit Courts of Appeals. Each of these cases will be dealt with in turn.

Initially, Licht alleges that the Fifth Circuit's opinion in this case conflicts with this court's opinion in *Commissioner of Internal Revenue v. National Alfalfa Dehydrating and Milling Co.*, 417 U.S. 134 (1974). *National Alfalfa* is a case which deals with the tax consequences of a debt for equity exchange. *Id.* at 147. As noted by the Fifth Circuit, the different policies underlying the Tax Code and the Bankruptcy Code make tax cases such as *National Alfalfa* inapplicable to the instant case. *Pengo* at 550.

Even if *National Alfalfa* did apply to the instant case, however, it would not conflict with the Fifth Circuit's decision in this case. In *National Alfalfa*, this court upheld the finding of the tax court:

> That when a corporation issues obligations in exchange for its outstanding preferred, no discount arises if the amount that had been received upon the issuance of the preferred was equal to the face amount of the obligation issued upon the exchange.

National Alfalfa at 141-42. Because a full $1,000 was originally received by Pengo for the 8.5% debentures in this case, no discount arose when such debentures were exchanged for a Class A and Class B debenture combination with a total face value of $1,000. As such, even if applicable, *National Alfalfa* is not in conflict with the Fifth Circuit's opinion in this case.

Licht next alleges that the Fifth Circuit's opinion in this case is in conflict with a Tenth Circuit opinion in *Atchison T & S R.R. Co. v. United States*, 443 F.2d 147 (10th Cir. 1971). *Atchison*, however, has no bearing upon a debt for debt exchange in the bankruptcy context such as that involved in this matter. Rather, *Atchison* is a tax refund case. *Id.* at 148. As such, there can be no conflict between *Atchison* and the Fifth Circuit's opinion in the instant case.

Licht next alleges that the Fifth Circuit's opinion in this matter is in conflict with its previous decision in *Gulf M & O R.R. v. United States*, 579 F.2d 892 (5th Cir. 1978). Initially, like *National Alfalfa*, *Gulf* was a case involving the Tax Code and not the Bankruptcy Code. *Id.* Furthermore, in *Gulf*, a corporation exchanged preferred stock with a stated value of $100 for debentures with a face value of $100. *Id.* at 894-95. Thus, rather than a debt for debt exchange, the Fifth Circuit in *Gulf* was dealing with a debt for equity exchange. Further, in *Gulf*, the corporation asserted that there was a discount in the transaction because the market value of the preferred stock on the date of the exchange was approximately $11,800,000, and such stock was exchanged for debentures with a face value of approximately $18,700,000. *Id.* The Fifth Circuit stated that "the controlling test from *National Alfalfa* is whether 'some cost . . . of acquiring the use of capital' occurred, not whether additional capital was acquired." *Id.* at 896. After analyzing the transaction, the Fifth Circuit determined that Gulf actually incurred additional costs upon the exchange. *Id.* at 898. This decision was not based on the market value of the preferred stocks on the date of the exchange. Rather, the court followed *National*

Alfalfa by basing its decision on the fact that the $100 preferred stock was originally sold by the corporation for much less than $100. *Id.* This is distinguishable from the *Pengo* case in which the original debentures issued by Pengo were sold at their face value. Thus, *Gulf*, if applicable, is not in conflict with the Fifth Circuit's opinion in this matter.

Finally, Licht alleges that the Fifth Circuit's opinion in this matter is in conflict with the Ninth Circuit's holding in *In Re Nucorp Energy Sec. Litig.*, 772 F.2d 1486 (9th Cir. 1985). The *Nucorp* decision, however, bears no resemblance to the instant matter. In fact, in *Nucorp*, the court dealt with the issue of the transfer of ownership of a cause of action for violation of federal securities regulations to subsequent bond purchasers. *Id.* at 1488. Clearly, the facts of *Nucorp* are not applicable to the facts of the instant matter. As such, there can be no conflict between these two decisions.

As a final matter, Licht lists the case of *In Re Allegheny Int'l, Inc.*, 100 B.R. 247 (Bkrtcy. W.D. PA. 1989) as a related case to the instant matter. As the Fifth Circuit noted in its opinion in this matter, *Allegheny* was concerned with a pre-bankruptcy debt for equity swap, and not a debt for debt exchange. *Pengo* at 550. As such, the factual backgrounds of the cases are distinguishable and the holdings in the cases are not in conflict.

Licht has asserted in his Petition for Writ of Certiorari that this court should review the Fifth Circuit's opinion in the instant matter due to its conflict with opinions issuing from other courts. As demonstrated above, there is no conflict between the Fifth Circuit's

opinion in this case and any other case dealing with the issues herein involved. In fact, the only other Circuit Court of Appeals case which deals with a debt for debt face value exchange in a consensual out of court restructuring is in total agreement with the opinion in this matter. As such, Licht's Petition for Writ of Certiorari should be denied.

CONCLUSION

The United States Court of Appeals for the Fifth Circuit has issued a well reasoned and sound opinion that both supports and furthers the underlying policy of the Bankruptcy Code to encourage out of court workouts. By holding that a debt for debt face value exchange in a consensual out of court restructuring does not create unmatured interest in the form of original issue discount within the meaning of the Bankruptcy Code, the Fifth Circuit Court of Appeals has issued an opinion that is in compliance with the underlying purposes of the Bankruptcy Code and which is grounded in sound public policy. Furthermore, the opinion issued by the Fifth Circuit Court of Appeals does not conflict with any other Circuit Court opinion which has dealt with this factual situation. As such, this court should deny Licht's Petition

for Writ of Certiorari. The Respondent also requests all other relief to which this court may find it entitled.

Respectfully submitted,

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92-596

NO. 92-~~926~~

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1992

DR SEYMOUR LICHT P.E.

Petitioner

vs

TEXAS COMMERCE BANK ET AL

Respondents

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF IN SUPPORT OF WRIT OF CERTIORARI

DR SEYMOUR LICHT P.E.
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TEXAS COMMERCE NATIONAL BANK'S RESPONSE IS NON- RESPONSIVE TO DR SEYMOUR LICHT QUESTIONS PRESENTED TO THIS COURT

Licht presented four questions (unanswered by TCNB) to this Honorable Court (see page "i" of Licht's Petition):

> 1. Where an interest bearing debenture is voluntarily exchanged for a "**Zero Coupon**" debenture plus other consideration ("**Boot**"): must the value of the "Boot" be subtracted from an exchanging debenture holder's claim in a subsequent bankruptcy proceeding?
>
> 2. Is unmatured interest on a "**Zero Coupon**" debenture allowable as a claim under 11 U.S.C. Section 502 (b)(2)?
>
> 3. Did the Fifth Circuit err in holding that the allowed bankruptcy claim of an unmatured $1,000.00 "**Zero Coupon**" bondholders is equal to the face amount of the "Zero Coupon"?
>
> 4. Can a Court of Appeals base its ruling on facts that are not contained in the record before the trial court?

In its Response Brief (Brief") Texas Commerce National Bank ("TCNB") attempts to evade the questions presented to the Court by unfairly re-formulating the issue as: (see page "i" of TCNB's Response Brief)

> "Does a **debt for debt face value exchange** in a consentual out of court restructuring create unmatured interest, in the form of original issue discount, within the meaning of the Bankruptcy Code provisions which disallows claims for unmatured interest?" (Emphasis added)

This question is unrelated to Licht's Petition and has nothing to do with the four (4) questions that Licht has brought before this Honorable Court.

TCNB can not claim that the reason that they ignored Licht's questions was because Licht's petition is poorly worded and did not present his arguments concisely. The October

22, 1992 issue of "BNA's Bankruptcy Law Reporter" reviewed Licht's petition in detail and cited the key points that Licht has presented to this Court in his Petition.

BNA concludes its review of Licht's petition with the following statement on page 1202:

> "The petitioner concludes that the Supreme Court should require that the claim of a "Zero Coupon" bondholder be reduced by an amount equal to the "*Unmatured interest*" for the period from the bankruptcy petition to the maturity date of the zero coupon bond and should be further reduced by the present value of the "Boot" received at the time of the exchange."

TCNB did not address these issues presumably it could not provide this Honorable Court with any rational argument in opposition to Licht's position that would also be consistent with the Fifth Circuit's ruling. Consequently TCNB addressed an

unrelated question. TCNB's unrelated response is similar to the situation where somebody has lost their wallet on Central Avenue and 3rd Street, but they went looking for it on Camelback Road and 5th Avenue because there is more light. TCNB could not answer Licht's questions so they presented their own unrelated question and answered it.

TCNB'S MISSTATEMENT OF FACTS IN THEIR RESPONSE BRIEF

On page 3 of TCNB's response brief TCNB states:

> "The debenture Holders who participated in this exchange waived the payment of past due interest (*Id.* at paragraph 24). Further, Pengo gained an additional benefit because the new Class A and Class B debentures were non-interest bearing, **allowing Pengo to accrue no interest expense with respect to the Class A and Class B debentures** (at paragraph 21) (Emphasis added).

Pengo used the accrual method of accounting. In accordance with the Financial Accounting Standard Board ("FASB") guidelines regarding "Zero Coupon" bonds Pengo made the following adjusting entries on their balance sheet upon consummation of the exchange offer for each $1,000.00 of the 8.5% bond exchanged for a $1,000.00 "Zero Coupon" bond (see "Licht's Objection to Claims of TCNB":

> a) Reduced its liability from $1,000.00 to $320.00 for each $1,000.00 8.5% bond exchanged;
>
> b) Eliminated $255.00 of accrued interest expense but not paid for each $1,000.00 8.5% bond exchanged;
>
> c) **Accrued** each year $90.67 of interest expense for each $1,000.00 "Zero Coupon" bond issued.

Contrary to TCNB assertion Pengo accrued the annual interest expense relating to the "Zero Coupon" bonds each year. Pengo, however, did not pay the interest. Pengo would have paid the interest $660.00

[($1,000.00) - ($340.00)] when they paid $1,000.00 on the maturity date of the "Zero Coupon" bond (see page 36 of Licht's petition).

PENGO'S EXCHANGE WAS NOT A FACE FOR FACE EXCHANGE

On page 4 of the Brief TCNB states:

> "In affirming the District Court's decision, the Fifth Circuit relied on an opinion issued by the Second Circuit Court of Appeals in *LTV Corp. v. Valley Fidelity Bank & Trust Co. (In Re Chateaugay Corp.)*, 961 F2d 378 (2nd Cir. 1992). In *Chateaugay*, the Second Circuit dealt with a fact situation in which the company exchanged new senior notes with a face value of $1,000.00 for an old debenture with a face value of $1,000.00. *Id.* at 380."

Again TCNB misrepresents fact that was known or should be known to them. The Chateaugay exchange was not a **"Face for Face"** exchange.

Chateaugay at 380:

> "In May 1986 LTV offered to exchange $1,000.00 face amount of New Notes and **15 shares of LTV common stock** for each $1,000.00 face amount of Old Debentures.

The fifteen (15) shares of LTV common stock had significant value at the time of the exchange and hence its value must be

considered when determining a subsequent bankruptcy claim.

TCNB further states on page 4 of their Brief:

> "As in *Chateaugay*, the Pengo exchange offer constituted a face value exchange meaning that rather than issuing the Class A and Class B debentures at a discount creating unmatured interest "Pengo simply substituted" new indebtedness for existing debentures, modifying terms and conditions but not reducing the principle amount of the debt. "*Pengo* at 547. (Citation omitted).(Emphasis added)

Again TCNB has misrepresented the true fact known to them. Pengo's exchange offer was clearly **NOT** a face for face exchange. Pengo exchanged a $1,000.00 "Zero Coupon" bond for a $1,255.00 ($1,000.00 principal plus $255.00 of accrued but unpaid interest) 8.5% bond.

TCNB also admits that the "**terms and conditions**" under which the "Zero Coupon" bond was issued was changed. TCNB contends that the modifications of these conditions

were insignificant. Licht's position is that without the modifications nobody would have accepted the exchange offer.

Pengo's "Exchange offering Circular" on page #1 (attached to "Licht's Objections to Claims of TCNB" and is part of the record before the Fifth circuit it states):

> "Pengo Finance N.V. ("Finance") hereby offers to holders of its **8.5% per. cent. Convertible Subordinated Guaranteed Debentures 1995** ("Old Debentures") upon the terms and conditions set forth herein and in the accompanying Letter of transmittal (which together constitute the "Exchange offer") $500 principal amount of its **Class A Non-interest Bearing Convertible Senior Subordinated Guaranteed Debentures due December 1, 1991 (Class A Debentures") and $500 principal amount of its Class B Non-interest Bearing Convertible Senior Subordinated Guaranteed Debentures due December 1, 1991 (Class B Debentures")** in exchange for each $1,000.00 principal amount of its Old Debentures. ***Accrued but unpaid interest on the tendered and accepted Old Debentures will be canceled.*** The Class A Debentures and Class B Debentures are

> collectively referred to as the "New Debentures". Old Debentures will be accepted only if tendered along with all coupons for interest payable on or subsequent to December 1, 1993."

The Fifth Circuit's ruling considered only part of Pengo's exchange offer. If Pengo only offered a $1,000.00 face amount "Zero Coupon" bond in exchange for a 8.5% subordinated convertible debenture with approximately four years of accrued but unpaid interest, not a single bondholder would accept said offer. **Pengo provided sufficient additional inducement to the 8.5% bond holders to accept the exchange offer by:**

a) Shortening the maturity date of the "Zero Coupon" bond from 1995 to 1991;

b) Making the "Zero Coupon" bond senior to the 8.5% bond;

c) Reducing the convertibility of the "Zero Coupon" bond to $1.25 per share while the conversion rate of the 8.5% bond remained

at $32.25 per share. (This resulted in $8,631,500.00 of "Zero Coupon" bonds being converted in Pengo stock)

Based on the financial value of the above described "Boot" Pengo's exchange was consummated. $13,365,000.00 in face amount of the 8.5% bonds were exchanged. Pengo issued $6,602,500.00 of Class A and $6,602,500.00 Class B (see stipulated facts 12 & 21). TCNB filed claims for $2,076,000.00 Class A and $2,236,000.00 Class B "Zero Coupon" bonds (see stipulated facts 6 & 7). Consequently $4,265,000.00 of Class A and $4,366,500.00 Class B "Zero Coupon" bonds were converted to Pengo common stock prior to the bankruptcy filing. Pengo's common stock at the time of the exchange had a high of $1.75 and a low of $0.6875 per share (see stipulated fact # 18).

The conclusion made by the Fifth Circuit that the Pengo's exchange was a "Face for Face" exchange could not be further from the truth. The above-described boot had significant financial value at the time of the exchange and hence the value of the "Boot" at the time of the exchange offer must be subtracted from the claim of a "Zero Coupon" bond holder in a subsequent bankruptcy. Even if this Court disregards the value of the "Boot" received by exchanging bondholders the Fifth Circuit decision that the exchange was a "FACE FOR FACE" exchange still fails to met muster. In exchange for a $1,000.00 "Zero Coupon" bond Pengo received a $1,000.00 8.5% bond and did not have to pay the accrued interest of $255.00 on each $1,000.00 8.5% bond that Pengo was carring on their books as a current liability. A $1,000.00 8.5% bond. plus $255.00 of accrued interest forgiveness, is not equal to a $1,000.00 "Zero Coupon" bond This conclusion violates all financial principal.

CONCLUSION

The United States Court of Appeals for the Fifth Circuit has clearly erred when it issued its opinion stating that the Pengo Exchange offer did not create an OID because it was a "FACE FOR FACE" exchange. The Fifth Circuit based this ruling on the fact that a $1,000.00 8.5% bond was exchanged for a $1,000.00 "Zero Coupon" bond. The Fifth Circuit disregarded the financial value of the "Boot' that accepting bondholders received and the forgiveness of the accrued but unpaid interest that Pengo received.

Licht prays that this Honorable Court will grant his Petitioner for Certiorari because left undisturbed, the Fifth Circuit's ruling below chills future out of court debt restructuring.

The petition also requests any and all other relief that this Honorable Court deems that he is entitled to.

Respectfully Submitted:

Dated this 9th day of November 1992:

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